No. 91-615-CSX
Status: GRANTED

Title: Allied-Signal, Inc., as successor-in-interest to The Bendix Corporation, Petitioner
v.
Director, Division of Taxation

Docketed:
October 11, 1991

Court: Supreme Court of New Jersey

Counsel for petitioner: Willson Jr.,Prentiss

Counsel for respondent: Hamill,Mary R.

101191 Counsel states respond shld be as above & is out of NJ

Entry	Date	Note	Proceedings and Orders
1	Oct 11 1991	G	Petition for writ of certiorari filed.
2	Nov 13 1991		DISTRIBUTED. November 27, 1991
3	Nov 15 1991	X	Brief of respondent Director, Division of Taxes in opposition filed.
4	Nov 21 1991	X	Reply brief of petitioner Allied-Signal, Inc. filed.
5	Nov 27 1991		Petition GRANTED.
			**********
6	Jan 2 1992		SET FOR ARGUMENT WEDNESDAY, MARCH 4, 1992. (2ND CASE)
9	Jan 9 1992		Brief amicus curiae of Williams Companies, Inc. filed.
7	Jan 10 1992		Joint appendix filed.
8	Jan 10 1992		Brief of petitioner Allied-Signal, Inc. filed.
10	Jan 10 1992		Brief amicus curiae of Committee on State Taxation filed.
12	Jan 16 1992		Record filed.
		*	Certified record and proceedings Supreme Court of New Jersey (1 Box).
11	Jan 24 1992		CIRCULATED.
16	Feb 7 1992	X	Brief amici curiae of California, et al.(TO BE RECOVERED) filed.
13	Feb 10 1992	X	Brief of respondent Director, Division of Taxation filed.
14	Feb 10 1992	X	Brief amici curiae of Massachusetts, Connecticut, Maryland and Virginia filed.
15	Feb 10 1992	X	Brief amicus curiae of Multistate Tax Commission filed.
17	Feb 26 1992	X	Reply brief of petitioner Allied-Signal, Inc. filed.
18	Mar 4 1992		ARGUED.

91-615

No. 91-

FILED
OCT 11 1991
OFFICE OF THE CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of New Jersey

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Due Process and Commerce Clauses preclude a state from imposing a tax on income that a nondomiciliary corporation derives from the sale of its minority interest in another corporation, when the two corporations are not engaged in a unitary business and when the only connection between the taxpayer's minority investment and the taxing state lies in the taxpayer's subsequent use of the proceeds from the sale of its investment.

2. Whether this Court should now clarify, or should additionally articulate, the criteria it has set forth in *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and related cases, so as to forestall the widespread efforts of states to extend their taxing power well beyond traditional constitutional confines by taxing intangible income with which they have no substantial connection.

LIST OF PARTIES

The parties are as stated in the caption. In the courts below, the taxpayer was referred to as The Bendix Corporation. As appears in the Rule 29.1 Statement, Allied-Signal Inc. has become the successor-in-interest to The Bendix Corporation by successive mergers.

RULE 29.1 STATEMENT

Pursuant to Rule 29.1 of the Rules of this Court, petitioner states that prior to January 31, 1983, The Bendix Corporation had no parent corporation. On January 31, 1983, The Bendix Corporation became a wholly-owned subsidiary of Allied Corporation, which then had no parent corporation. On March 31, 1985, The Bendix Corporation was merged into Allied Corporation. Subsequent to March 31, 1985, and prior to September 30, 1987, Allied Corporation was a wholly-owned subsidiary of The Signal Companies, Inc., which in turn was a wholly-owned subsidiary of Allied-Signal Inc. On September 30, 1987, both of these subsidiaries were merged into the parent company, Allied-Signal Inc. Allied-Signal Inc. has no parent corporation. Its non-wholly-owned subsidiaries are listed in the Appendix to this petition at App. E at 72a.[1]

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[1] All references to the Appendix in this petition are denominated "App." followed by a unique letter assigned to each item and a page reference.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	v
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT	3
1. Bendix's Business	3
2. Bendix's Acquisition and Sale of Its Interest in ASARCO	4
3. The Assessment	5
4. The Proceedings Below	6
REASONS FOR GRANTING THE WRIT	8
I. THE DECISION BELOW CLEARLY CONFLICTS WITH THE DECISIONS OF OTHER STATE COURTS OF LAST RESORT	9
II. THE DECISION BELOW PRESENTS RECURRING CONSTITUTIONAL ISSUES OF PROFOUND NATIONAL SIGNIFICANCE WARRANTING THIS COURT'S REVIEW	14

Page

III. THE DECISION BELOW IS INCOMPATIBLE WITH PRIOR DECISIONS OF THIS COURT AND, IF LEFT UNDISTURBED, WILL UNDERMINE ESSENTIAL CONSTITUTIONAL RESTRAINTS ON STATE TAXATION 17

CONCLUSION 23

APPENDIX 1a

Appendix A: Opinion of the Supreme Court of New Jersey, July 16, 1991 ..... 1a

Appendix B: Opinion of the Superior Court of New Jersey, Appellate Division, October 19, 1989 ..... 25a

Appendix C: Opinion of the New Jersey Tax Court, June 30, 1988 ..... 45a

Appendix D: New Jersey Statutes Involved 68a

Appendix E: Rule 29.1 List 72a

TABLE OF AUTHORITIES

Page(s)

Cases

American Home Products Corp. v. Limbach,
49 Ohio St. 3d 158, 551 N.E.2d 201,
cert. denied, 111 S. Ct. 63 (1990) 13

ASARCO, Inc. v. Idaho State Tax Comm'n,
458 U.S. 307 (1982) ..... *passim*

Brunner Enter., Inc. v. Dep't of Revenue,
452 So. 2d 550 (Fla. 1984) 13

Container Corp. of America v. Franchise Tax Bd.,
463 U.S. 159 (1983) 15, 16, 17, 18

Corning Glass Works, Inc. v. Virginia Dep't of Taxation,
241 Va. 353, 402 S.E.2d 35 (1991),
cert. denied, 60 U.S.L.W. ____
(U.S. Oct. 7, 1991) (No. 90–1852) ..... *passim*

Exxon Corp. v. Wisconsin Dep't of Revenue,
447 U.S. 207 (1980) 15, 16, 17

James v. Int'l Tel. & Tel. Corp.,
654 S.W.2d 865 (Mo. 1983) 12

Page(s)

Lone Star Steel Co. v. Dolan,
668 P.2d 916 (Colo. 1983) 13

Miller Bros. v. Maryland,
347 U.S. 340 (1954) 17

Mobil Oil Corp. v. Comm'r of Taxes,
445 U.S. 425 (1980) ..... *passim*

NCR Corp. v. Comptroller,
313 Md. 118, 544 A.2d 764 (1988) 13

Northwestern States Portland Cement Co. v. Minnesota,
358 U.S. 450 (1959) 16

Pledger v. Illinois Tool Works, Inc.,
306 Ark. 134, 812 S.W.2d 101 (1991),
petition for cert. filed, 60 U.S.L.W. ____
(U.S. Sept. 23, 1991) (No. 91-530) 3, 9, 11, 12,

Qualls v. Montgomery Ward & Co.,
266 Ark. 207, 585 S.W.2d 18 (1979) 11

F.W. Woolworth Co. v. Taxation and Revenue Dep't,
458 U.S. 354 (1982) ..... *passim*

Page(s)

Constitutional Provisions and Statutes

U.S. Const., amend. XIV, § 1 2

U.S. Const., art. I, § 8, cl. 3 2

28 U.S.C. § 1257(a) 2

New Jersey Corporation Business Tax Act, N.J. Stat. Ann. (West 1986)
§ 54:10A–1 ..... 2, 5
§ 54:10A–2 ..... 2, 5
§ 54:10A–4(k) 2, 5
§ 54:10A–6 5

IN THE

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OCTOBER TERM, 1991

No. 91–

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

Petition for a Writ of Certiorari to the Supreme Court of New Jersey

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PETITION FOR A WRIT OF CERTIORARI

This petition for a writ of certiorari seeks this Court's review of the judgment of the Supreme Court of New Jersey on a nationally important matter relating to the constitutional limitations on the power of the states to tax the income of multistate enterprises.

OPINIONS BELOW

The opinion of the Supreme Court of New Jersey (App. A at 1a–24a) is reported at 125 N.J. 20, 592 A.2d

536. The opinion of the Superior Court of New Jersey, Appellate Division (App. B at 25a–44a), is reported at 237 N.J. Super. 328, 568 A.2d 59. The opinion of the New Jersey Tax Court (App. C at 45a–67a) is reported at 10 N.J. Tax 46.

JURISDICTION

The judgment of the Supreme Court of New Jersey was entered on July 16, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fourteenth Amendment of the United States Constitution, U.S. Const., amend. XIV, § 1, provides in pertinent part that: "[N]or shall any state deprive any person of life, liberty, or property, without due process of law."

Article 1, section 8, clause 3 of the United States Constitution, the Commerce Clause, U.S. Const., art. I, § 8, cl. 3, provides that: "To regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes."

Relevant portions of the New Jersey Corporation Business Tax Act, N.J. Stat. Ann. §§ 54:10A–1, –2, –4(k) (West 1986), are set forth at App. D at 68a–71a.

STATEMENT

The issues raised by this case—issues closely related to those raised in two other certiorari petitions recently filed in this Court[2] — concern the power of a state to tax the income earned by a nondomiciliary corporation from its investment in other corporations with which it has no functional connection and which it does not control. The precise question here is whether New Jersey may tax a share of the gain that a Michigan-based manufacturing corporation (Bendix) realized from the sale of its minority investment in an unrelated metal mining corporation (ASARCO). The facts, which have been stipulated, are not in dispute.

1. Bendix's Business

Petitioner Allied-Signal Inc. is the successor-in-interest to The Bendix Corporation, the original taxpayer in this case. Bendix was a Delaware corporation with its corporate headquarters and commercial domicile in Southfield, Michigan. Formed in 1929 as a manufacturer of aviation and automotive parts, Bendix gradually evolved, through both internal expansion and selective acquisition of other companies, into a multinational enterprise with operations in all 50 states and in 22 foreign countries. By the 1970s, Bendix's activities were concentrated in four core business groups: automotive,

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[2] *Corning Glass Works, Inc. v. Virginia Dep't of Taxation*, 241 Va. 353, 402 S.E.2d 35 (1991), *cert. denied*, 60 U.S.L.W. ____ (U.S. Oct. 7, 1991) (No. 90-1852); *Pledger v. Illinois Tool Works, Inc.*, 306 Ark. 134, 812 S.W.2d 101 (1991), *petition for cert. filed*, 60 U.S.L.W. ____ (U.S. Sept. 23, 1991) (No. 91-530).

aerospace/electronics, industrial/energy, and forest products.

2. Bendix's Acquisition and Sale of Its Interest in ASARCO

In 1978, Bendix purchased approximately 20.6 percent of the outstanding common stock of ASARCO, an unrelated corporation engaged in the business of mining and refining nonferrous metals. During the period that Bendix held its stock interest in ASARCO (1978–81), Bendix and ASARCO remained discrete business enterprises with virtually no corporate interaction. Aside from holding and overseeing the investment itself, which it undertook in Southfield, Michigan, Bendix did not engage in any activity in New Jersey or elsewhere that involved the nonferrous metal production business or any other business or activity in which ASARCO was engaged. Stipulation of Facts, *Bendix Corp. v. Director, Div. of Taxation*, No. 14–24–0504–84–CB (N.J. Tax Ct.), at ¶ 41.[3] Indeed, the Stipulation of Facts in this case unequivocally states that "[d]uring the period that Bendix held its investment in Asarco, Bendix and Asarco were unrelated business enterprises each of whose activities *had nothing to do with the other*." Stip. ¶ 62 (emphasis added).

In 1981, Bendix sold its ASARCO shares to ASARCO and realized a capital gain of approximately $211.5 million.

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[3] All references to the Stipulation of Facts in this case are denominated "Stip." followed by a paragraph reference.

3. The Assessment

New Jersey imposes its Corporation Business Tax ("CBT"), N.J. Stat. Ann. §§ 54:10A–1 *et seq.*, upon every corporation for the privilege of exercising its corporate franchise, doing business, employing or owning capital or property, or maintaining an office in the state. *Id.* § 54:10A–2 (App. D at 68a). The CBT is measured by a corporation's "entire net income,"[4] regardless of its connection to New Jersey. *Id.* § 54:10A–4(k) (App. D at 69a). A taxpayer's "entire net income" is defined as its federal taxable income, as adjusted for New Jersey tax purposes.[5] *Id.* A taxpayer who maintains a regular place of business outside the state may apportion its income to New Jersey by the familiar three-factor formula of property, payroll, and sales. *Id.* § 54:10A–6.

On its 1981 CBT return, Bendix excluded from its "entire net income" the gain attributable to the sale of its ASARCO stock, on the ground that New Jersey could not constitutionally include in Bendix's apportionable tax base the income from its investment in a corporation whose business activities had nothing to do with Bendix's business activities in New Jersey.[6] *See ASARCO,*

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[4] During the tax year at issue (1981), the CBT was measured both by net income and by net worth. There is no dispute here regarding the tax on net worth, which was repealed for tax years ending after June 30, 1986.

[5] None of these adjustments is at issue here.

[6] Bendix also excluded capital gain income from the sale of a subsidiary, United Geophysical Corporation, and interest income that Bendix earned on the proceeds of the ASARCO and United Geophysical sales. Although both of these items were at issue in the

Footnote Continued ...

Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982). The Director of the Division of Taxation determined that Bendix was not entitled to the full refund claimed on its 1981 return, based in part on his position that Bendix's gain from the sale of its ASARCO stock was taxable by New Jersey.

4. The Proceedings Below

How the federal questions were raised and passed on below. In its complaint and briefs in the New Jersey Tax Court, in its briefs in the Appellate Division of the Superior Court of New Jersey, and in its briefs in the Supreme Court of New Jersey, Bendix contended that the federal Constitution precluded New Jersey from taxing the income from the sale of its ASARCO stock. These courts explicitly noted and ruled on Bendix's Due Process and Commerce Clause objections. App. A at 1a–2a, 22a; App. B at 28a, 44a; App. C at 45a, 67a.

The decisions below. The New Jersey Tax Court and the Appellate Division of the Superior Court of New Jersey both cited this Court's decisions in *ASARCO* and *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354 (1982). App. B at 30a, 31a, App. C at 59a n.3. The Appellate Division even recognized that this Court's decisions barred the states from taxing the investment income earned by a nondomiciliary corporation from its investment in another corporation unless the two corpo-

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Footnote Continued from Previous Page

courts below, petitioner is not pressing in this Court its claims with respect to these items.

rations were engaged in a unitary business. App. B at 29a–31a. Moreover, the Appellate Division acknowledged that "*Asarco* and *F.W. Woolworth* cast a dark shadow over the Tax Court's decision . . . ." App. B at 32a. Both courts nevertheless rejected Bendix's constitutional objections, reasoning that Bendix's activities in managing its investment in ASARCO provided a sufficient link between New Jersey and Bendix's gain to permit New Jersey to tax it.

The New Jersey Supreme Court affirmed. App. A at 24a. It recognized that, in order to tax an apportioned share of the income earned by a nondomiciliary corporation conducting a multistate business within the state, the state must have a minimum connection with the activities that generate such income. That minimum connection, the court further recognized, exists when the income in question is derived from a unitary business conducted both within and without the state.

In addressing the question whether Bendix's income from its investment in ASARCO was derived from a unitary business carried on in New Jersey, however, the state court did not focus on the relationship of the underlying activities of the two enterprises as this Court had done in its unitary business opinions. *See Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980); *ASARCO*; *Woolworth*. Indeed, the court took no exception to the parties' stipulation that Bendix and ASARCO had nothing to do with each other.

Rejecting the view that "[t]he tests for determining a unitary business are ... controlled ... by the relationship between the taxpayer recipient and the affiliate generator of the income that becomes the subject of the State tax," App. A at 18a, the court instead fashioned a test that fo-

cused on "the intangible nature of corporate operations ... to determine the existence of a unitary business." *Id.*

From that perspective, the New Jersey court examined Bendix's corporate policy for holding investments in stock to determine whether Bendix's gain from the sale of the ASARCO stock was apportionable under the unitary business principle. App. A at 18a–21a. Applying this test, the New Jersey Supreme Court found that Bendix had an "ingrained policy of acquisitions and divestitures" which "projected the existence of a unitary business." App. A at 21a.

The court's assertion that Bendix "had a business function of corporate acquisitions and divestitures that was an integral operational activity," App. A at 18a–19a, did not by itself demonstrate that this activity had anything to do with Bendix's operations in New Jersey. The court attempted to forge this link by looking beyond the relationship between Bendix's investment activity and its investment in ASARCO. It relied on the use that Bendix made of the proceeds from the sale of its ASARCO stock, when Bendix no longer had any connection with ASARCO. The proceeds were used to acquire stock in Martin Marietta Corporation, and "the purpose of acquiring Martin Marietta was to complement the aerospace-electronics facets of Bendix['s] business, some of which are located in New Jersey." App. A at 20a.

REASONS FOR GRANTING THE WRIT

The decision of the New Jersey Supreme Court warrants review by this Court for three compelling reasons. First, the fundamental question raised by this case—whether a state may tax the income of a nondomiciliary corporation from its investment in another corporation

with which it has no operational links—has given rise to a clear conflict among state courts of last resort that only this Court can resolve. Second, the question raised by this case is a recurring issue of profound national significance that merits plenary consideration in its own right. Third, the New Jersey Supreme Court's resolution of the question is incompatible with prior decisions of this Court and, if left undisturbed, would undermine essential constitutional constraints on state taxation and would stimulate aggressive unconstitutional taxation not only by New Jersey, but by other states as well.

I. THE DECISION BELOW CLEARLY CONFLICTS WITH THE DECISIONS OF OTHER STATE COURTS OF LAST RESORT

In holding that New Jersey could tax Bendix's income from the sale of its ASARCO stock even though Bendix and ASARCO were not engaged in a unitary business, the New Jersey Supreme Court has created an irreconcilable conflict with decisions of other state courts of last resort. The Supreme Court of Virginia and the Supreme Court of Arkansas have recently ruled that a state may not tax a nondomiciliary corporation's income from the sale of its stock in another corporation unless the two corporations are engaged in a unitary business. *Corning*; *Illinois Tool Works, Inc.* The Virginia and Arkansas decisions, and other state court rulings to the same effect, cannot be reconciled with the New Jersey court's decision in this case.

In *Corning*, the question was whether Virginia could tax an apportioned share of the capital gains and interest income that Corning Glass Works, Inc., a nondomiciliary corporation, earned from its investment in Owens-Corning Fiberglas Corporation. The underlying business

activities of Corning and Owens-Corning did not constitute a unitary business. The Virginia Department of Taxation nevertheless contended, just as the New Jersey Supreme Court reasoned in the decision below, that "Corning Glass' acquisition and divestiture of stock was 'a regular and integral' business activity which rendered its relationship with Owens-Corning 'unitary.'" *Corning*, 241 Va. at ___, 402 S.E.2d at 37 (App. in No. 90–1852 at A5). This "unitary" link purportedly provided the constitutional predicate for the Virginia Department of Taxation's effort to tax Corning's income from its investment in Owens-Corning.

The Virginia Supreme Court unequivocally rejected this line of argument. Based on its review of this Court's decisions in *Mobil*, *ASARCO*, and *Woolworth*, the court held that it was the underlying relationship between the business activities of Corning and Owens-Corning, not the relationship of Corning to its stock investment in Owens-Corning, that formed the touchstone of unitary business analysis. The court stated that:

> [T]he Department may not, consistent with due process, tax the capital gains and interest income that Corning Glass received from the sale of its Owens-Corning stock. The "factors of profitability" arising "from the operation of the business as a whole" do not evidence the operation of a unitary business between Corning Glass and Owens-Corning.
>
> . . . .
>
> It is true that Corning Glass had significant stock holdings in Owens-Corning and other corporations. However, this fact alone is not sufficient to support a

> legal conclusion that a unitary business relationship existed between Corning Glass and Owens-Corning.

Corning, 241 Va. at ___, 402 S.E.2d at 39–40 (App. in No. 90–1852 at A11–A12).

In *Illinois Tool Works, Inc.*, the question was whether Arkansas could tax an apportioned share of the capital gains income that Illinois Tool Works, Inc., a nondomiciliary corporation, earned from the sale of its minority interest in several other corporations. The underlying business activities of Illinois Tool Works, Inc., and these other corporations did not constitute a unitary business. The Arkansas Commissioner of Revenues nevertheless contended, much as the New Jersey Supreme Court reasoned in the decision below, that the capital gains income was taxable by Arkansas even though a unitary relationship did not exist between Illinois Tool Works, Inc., and its minority investments. *Illinois Tool Works, Inc.*, 306 Ark. at ___, 812 S.W.2d at 102–03 (App. in No. 91–530 at A2–A5).

Like the Virginia court in *Corning*, the Arkansas court in *Illinois Tool Works, Inc.* squarely rejected the rationale underlying the New Jersey Supreme Court's decision. Observing that the Arkansas Commissioner's argument was supported in part by a state court decision[7] antedating this Court's decisions in *Mobil*, *ASARCO*, and *Woolworth*, the court held that the argument could not survive these precedents. *Illinois Tool Works, Inc.*, 306 Ark.

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[7] The decision was *Qualls v. Montgomery Ward & Co.*, 266 Ark. 207, 585 S.W.2d 18 (1979).

at ____, 812 S.W. 2d at 104 (App. in No. 91–530 at A7–A8). The court stated that:

> Under the "unitary business" rationale, as expressed in these decisions, the general test for determining whether a diversified group of businesses had a "unitary business" relationship was to determine whether the income that the state was attempting to tax resulted from functional integration, centralization of management, and economies of scale utilized by the corporate group.

Illinois Tool Works, Inc., 306 Ark. at ___, 812 S.W.2d at 103 (App. in No. 91–530 at A5). The conflict between the Arkansas and New Jersey Supreme Courts' reading of this Court's opinions is further illustrated by the Arkansas court's remark that this Court in *ASARCO* had rejected the argument that investment income "should be considered part of a 'unitary business' if the intangible property is acquired, managed or disposed of for purposes relating or contributing to the taxpayers' business." *Id.*[8]

Moreover, decisions of at least two additional state courts of last resort—Missouri and Florida—are in accord with the Virginia and Arkansas decisions in *Corning* and *Illinois Tool Works, Inc.* and are squarely in conflict with the New Jersey decision here, both in language and in result. *See James v. Int'l Tel. & Tel. Corp.*, 654 S.W.2d 865, 868 (Mo. 1983) (*en banc*) (*ASARCO* precludes apportionment

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[8] The Arkansas court also noted its agreement with the Virginia Supreme Court's decision in *Corning*. *Illinois Tool Works, Inc.*, 306 Ark. at ___, 812 S.W.2d at 104 (App. in No. 91-530 at A7–A8).

of capital gains income from sale of stock in nonunitary subsidiaries); *Brunner Enter., Inc. v. Dep't of Revenue*, 452 So. 2d 550, 552–53 (Fla. 1984) (*ASARCO* prohibits apportioned taxation of gain from nondomiciliary corporation's sale of stock). These important cases were all decided in the taxpayer's favor and are irreconcilable with New Jersey's position.

On the other hand, the New Jersey Supreme Court is not alone in holding that, in certain circumstances, a state may tax the income that a nondomiciliary corporation receives from its investment in another corporation even if the two corporations are not engaged in a unitary business. *See NCR Corp. v. Comptroller*, 313 Md. 118, 133–41, 544 A.2d 764, 771–75 (1988) (*ASARCO* does not prohibit apportioned taxation of income from investments in nonunitary enterprises when the investments were "actively monitored and carefully timed so as to meet [nondomiciliary taxpayer's] operating needs"); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916, 924–25 (Colo. 1983) (*ASARCO* does not require unitary business relationship between income-payor and income-recipient to support apportionment of interest income on intercorporate loans made as part of lender's unitary business); *American Home Products Corp. v. Limbach*, 49 Ohio St. 3d 158, 160-162, 551 N.E.2d 201, 204–205, *cert. denied*, 111 S. Ct. 63 (1990) (*ASARCO* does not prohibit apportionment of income from investments if the taxpayer uses the investments to secure loans of working capital or needs the investments to provide funds to operate its business).

Indeed, further confirmation of the existence of a clear and substantial conflict between the decision below and the decisions of other state courts of last resort is furnished by New Jersey's own acknowledgment that such a conflict exists. In the *Corning* case, New Jersey joined 19

other states in filing an amicus brief urging this Court to grant certiorari. Brief of Arkansas, et al., as Amici Curiae in Support of Petitioner, *Virginia Dep't of Taxation v. Corning Glass Works, Inc.*, No. 90–1852. In urging this Court to grant certiorari in the *Corning* case on the ground that "ASARCO HAS PRODUCED SUBSTANTIAL CONFLICT," *id.* at 5, Amici cited, among other cases, "*Bendix Corp. v. Director*, 10 N.J. Tax 46 (1988), *aff'd*, 237 N.J. Super. 328, 568 A.2d 59 (1989), *appeal pending* N.J. Sup. Ct. No. 31, 140." *Id.* at 8 n.4. That decision was affirmed by the New Jersey Supreme Court and is the subject of this petition.

In short, the evidence that the decision below is in conflict with recent decisions of other state courts of last resort is overwhelming, and this Court should grant certiorari to resolve the conflict.

II. THE DECISION BELOW PRESENTS RECURRING CONSTITUTIONAL ISSUES OF PROFOUND NATIONAL SIGNIFICANCE WARRANTING THIS COURT'S REVIEW

Wholly apart from the conflict that the decision below has created with the decisions of other state courts of last resort, the decision warrants this Court's review in its own right. The precise scope of the constitutional restraints on the states' power to tax the investment income of nondomiciliary corporations presents recurring questions of profound national significance that call for this Court's attention and guidance.

In a series of decisions handed down during the early 1980s,[9] this Court delineated the Due Process and Commerce Clause limitations on the states' power to tax the income of a multistate business. These decisions established a number of critical principles that broadly govern constitutional decision-making in this area. Thus *Mobil* announced and *Exxon* reiterated the fundamental proposition that "the linchpin of apportionability in the field of state income taxation is the unitary business principle." *Mobil*, 445 U.S. at 439; *Exxon*, 447 U.S. at 223. *ASARCO* and *Woolworth* articulated and applied the important corollary that intangible income may not be considered part of a nondomiciliary taxpayer's unitary business merely because "the intangible property (the shares of stock) is 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.'" *ASARCO*, 458 U.S. at 326. And *Container* further refined the requirement that "the out-of-state activities of the purported 'unitary business' be related in some concrete way to the in-state activities" by requiring that "there be some sharing or exchange of value ... —beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation." *Container*, 463 U.S. at 166.

Over the past decade, state courts have attempted to apply these principles to controversies over the scope of the states' power to tax the investment income earned by nondomiciliary corporations. These controversies have

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[9] *Mobil*; *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980); *ASARCO*; *Woolworth*; *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

arisen—and continue to arise—with increasing frequency as the state tax disputes spawned by the rash of acquisitions and divestitures that dominated the American financial markets during the 1980s wend their way through the state court systems. Despite the broad guidelines that this Court provided in *Mobil*, *Exxon*, *ASARCO*, *Woolworth*, and *Container*, courts continue to struggle with the precise limits on the power of states to tax the income that nondomiciliary corporations earn from their investment in other corporations. The result has been an outpouring of state court decisions, many of them inconsistent with one another, that have left state taxpayers and state taxing authorities without adequate guidance in this domain.

As revealed by the cases cited above (*see* pp. 12–13, *supra*), by the cases cited in the petitions for certiorari in Nos. 90–1852 and 91–530, and by the cases cited in the amicus brief in No. 90–1852, there are many state court decisions that reflect both uncertainty and confusion regarding the constitutional constraints on the states' power to tax the investment income of a nondomiciliary corporation. This Court's guidance is sorely needed to "clea[r] up the tangled underbrush of past cases"[10] and to provide clear direction to state taxpayers, state taxing authorities, and state courts regarding the constitutional restraints on the states' power to tax the income that nondomiciliary taxpayers earn from their investment in other corporations.

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[10] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457 (1959).

III. THE DECISION BELOW IS INCOMPATIBLE WITH PRIOR DECISIONS OF THIS COURT AND, IF LEFT UNDISTURBED, WILL UNDERMINE ESSENTIAL CONSTITUTIONAL RESTRAINTS ON STATE TAXATION

The most fundamental limitation on the states' power to tax, which is embodied in both the Due Process and the Commerce Clauses, is that there must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954). In the context of state corporate income taxation, when a state seeks to tax the income of a business engaged in activity across state lines, this nexus requirement is reflected in the unitary business principle. Under the unitary business principle, when a multistate business is carrying on a single "unitary" business both within and without the state, that state has the requisite nexus with both the in-state and the out-of-state activities of the business to justify the state's taxing an apportioned share of the income generated by these activities. By the same token, however, when the activities carried on within the state are not unitary with the activities carried on elsewhere, the state is constitutionally constrained from including the income arising from those discrete out-of-state activities in the taxpayer's apportionable tax base.

All of this was explained in this Court's decisions in *Mobil*, *Exxon*, *ASARCO*, *Woolworth*, and *Container*, to which we have frequently referred above. What was made particularly clear in *ASARCO* and *Woolworth*, however, was the application of these principles to the power of a state to tax the income that a nondomiciliary corporation derived from its investment in other corporations. First, this Court flatly repudiated the argument that in-

come from investments in intangible property should be considered part of a unitary business merely because

- the intangible property (the shares of stock) is "acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business," *ASARCO*, 458 U.S. at 326.

- the intangibles "contribute to or relate to or are some way in furtherance of the taxpayer's own trade or business," *id.* [or]

- th[e] "integration ... between the business use of the intangible asset (the shares of stock) and ... [the taxpayer's] business ... makes the income part of the unitary business." *Id.*

"This definition of unitary business," declared this Court, "*would destroy the concept.*" *Id.* (emphasis added).

Second, this Court rejected the notion that the possession of increased economic power that a nondomiciliary corporation enjoys as a result of its investment in other corporations provides a sufficient basis for a state to tax the income that the nondomiciliary taxpayer derives from those investments. Such a theory "would trivialize th[e] due process limitation by holding it satisfied if the income in question 'adds to the riches of the corporation.'" *Woolworth*, 458 U.S. at 363. The question is whether "the out-of-state activities of the purported 'unitary business' [are] related in some concrete way to the in-state activities," *Container*, 463 U.S. at 166, not "whether the nondomiciliary parent derives some economic benefit—as it virtually always will—from its ownership of stock in another corporation." *Woolworth*, 458 U.S. at 364.

Third, this Court unequivocally declared that it could not "accept, consistently with recognized due process standards, a definition of 'unitary business' that would permit nondomiciliary States to apportion and tax dividends '[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State.'" *ASARCO*, 458 U.S. at 327 (quoting *Mobil*, 445 U.S. at 442). Rather, there must be a substantial interconnection between the activities of the taxpayer *in the taxing state* and the corporation in which it has invested to justify the state's exercise of taxing power over the taxpayer's investment income.

Finally, this Court made it clear that the principles it articulated with respect to the states' power to tax the dividend income of a nondomiciliary corporation applied equally to the corporation's capital gains income, which is at issue here:

> Idaho and ASARCO agree that . . . capital gains income . . . should be treated in the same manner as the dividend income. . . . *We also agree.* "One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." Changing the form of the income "works no change in the underlying economic realities of [whether] a unitary business [exists], and accordingly it ought not affect the apportionability of income the parent receives."

ASARCO, 458 U.S. at 330 (emphasis added, citations omitted).

The decision below runs roughshod over these principles and, if left to stand, would leave them in shambles. First, the New Jersey Supreme Court has adopted the

very definition of a unitary business that this Court said would "destroy" or "trivialize" it. Relying on the "intangible nature of corporate operations ... to determine the existence of a unitary business," App. A at 18a, and pointing to Bendix's "ingrained acquisition-divestiture policy," *id.* and "long-term planning strategy," *id.*, the New Jersey court concluded that Bendix's "capital investment activities" had become "long-term integral operational functions." App. A at 19a. But this is precisely the argument that Idaho and New Mexico made in *ASARCO* and *Woolworth* and that this Court squarely repudiated. It is no more persuasive now than it was then.

Second, the New Jersey court took no issue with the stipulated fact that "[d]uring the period Bendix held its investment in Asarco, Bendix and Asarco were unrelated business enterprises each of whose activities *had nothing to do with the other*." Stip. ¶ 62 (emphasis added). The court nevertheless concluded that Bendix's investment in ASARCO constituted part of its unitary business in New Jersey. This flies in the face of this Court's admonition that it cannot accept, consistently with recognized due process standards, a definition of a unitary business that would permit a state to tax a nondomiciliary taxpayer's income from its investment in another corporation where the business activities of the two corporations "have nothing to do with" each other in the taxing state.[11]

Third, even assuming that a taxpayer's investment activities could be characterized as a part of its unitary

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[11] As noted above, this Court has held that this admonition applies no less to capital gains income than it does to dividend income.

business, the New Jersey court fails meaningfully to distinguish Bendix's investment in ASARCO from ASARCO's and Woolworth's investments in *ASARCO* and *Woolworth* that were held not to be part of the taxpayers' unitary businesses. To be sure, the New Jersey court characterizes the taxpayer's investments in *ASARCO* as not being "'integral to nor a necessary part of [ASARCO's] business operation,'" App. A at 21a, and it observes that ASARCO did not use "'its stock as security for borrowing of working capital [to] acquir[e] stock or securities in other companies.'" *Id.* But the court does not reveal how Bendix's investment in ASARCO was more "integral" to Bendix's business operations than ASARCO's investments, in *ASARCO*, were integral to its business operations in light of the stipulated facts. Stip. ¶ 62 (no intercompany loans; no joint borrowings; no intercompany guarantees; and no pledging of the ASARCO stock).

Indeed, a comparison of the facts of *ASARCO* and *Woolworth* with those of the decision below shows that *ASARCO* and *Woolworth* actually presented *stronger* cases for finding that the taxpayers' investment activities were part of their unitary businesses than does the instant controversy. Thus ASARCO held a majority interest in Southern Peru, a producer of unrefined copper, which sold about 35 percent of its output to ASARCO. *ASARCO*, 458 U.S. at 321. Woolworth held interests in one majority-owned and three wholly-owned subsidiaries that were engaged in precisely the same line of business as it was. *Woolworth*, 458 U.S. at 356–57. Here, by contrast, Bendix held a noncontrolling minority interest in a corporation that neither sold its output to Bendix nor was engaged in Bendix's line of business. It simply blinks the facts to conclude, as did the court below, that Bendix's investment in ASARCO was a part of its unitary

business whereas ASARCO's and Woolworth's investments were not part of their unitary businesses.

Finally, even assuming that Bendix's investment activities (including its investment in ASARCO) could properly be characterized as part of its unitary business, New Jersey's effort to explain what these activities have to do with Bendix's activities *in New Jersey* is wholly unsatisfactory. The court attempted to establish such a connection by looking beyond the relationship of Bendix's investment in ASARCO itself to the use that Bendix made of the proceeds from the sale of its ASARCO stock, when Bendix no longer had any connection whatsoever with ASARCO. The court noted that the proceeds were used to acquire Martin Marietta stock, and "the purpose of acquiring Martin Marietta was to complement the aerospace-electronics facets of Bendix['s] business, some of which are located in New Jersey." App. A at 20a. But if the use of proceeds from an investment, *after the taxpayer has disposed of all of its interest in the investment*, can establish a due process link between that investment and the state in which the proceeds are subsequently invested, the due process limitations on state taxation have not merely been "trivialized," they have been utterly obliterated.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

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APPENDIX A

BENDIX CORPORATION,
Plaintiff-Appellant,
v.
DIRECTOR, DIVISION OF TAXATION,
Defendant-Respondent.

Supreme Court of New Jersey.

Argued Jan. 14, 1991.
Decided July 16, 1991.

The opinion of the court was delivered by

MUIR, Jr., J.A.D., Temporarily Assigned.

On this appeal, plaintiff, Bendix Corporation, a multi-jurisdictional, non-domiciliary corporation doing business in New Jersey, argues New Jersey transgressed the due process and commerce clause limitations of the United States Constitution when the State taxed capital gains Bendix earned from the sale of all its stock in two corporate affiliates. In 1981, Bendix sold its 20.6% stock ownership in ASARCO Inc., and its 100% stock ownership in United Geophysical Corporation (UGC). New Jersey relied on the unitary business/formula apportionment method to assess the tax on the resulting capital gains and related interest. The assessment resulted in an additional tax liability of $1,845,000, which the State set off against Bendix's 1981 refund. The Tax

Court upheld the assessment. The Appellate Division affirmed. We now affirm.

I.

Bendix filed a complaint in the Tax Court challenging the deficiency assessment that arose from the Director's inclusion of the capital gains realized from the sales and related investment-account interest in the tax base of the apportionment formula employed to calculate Bendix's corporate business tax. The parties presented a stipulated record that included the deposition of W.M. Agee, chief executive officer of Bendix from 1977 to 1983. The Tax court found no constitutional infringement created by the tax imposition. It ruled Bendix a unitary business, concluding the active investment strategy that led to the capital gains made that intangible income unitary and, therefore, apportionable. The Tax Court reached its conclusion by focusing on the investment activities of Bendix rather than the activities of the corporation's affiliates or their relationship with Bendix. In making its decision, the Tax Court relied in particular on *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545 (1983), and *Silent Hoist & Crane Co. v. Director, Division of Taxation*, 100 N.J. 1, 494 A.2d 775 cert. denied, 474 U.S. 995, 88 L.Ed.2d 359 (1985). The court also ruled Bendix failed to establish any ground for altering the statutory allocation formula employed.

The Appellate Division affirmed. 237 N.J. Super. 328, 568 A.2d 59 (1989). While that court did not "fully subscribe" to the legal distinction the Tax Court made between dividends and capital gains and emphasized the factual difference between *Silent Hoist* and this case, see id. at 336, it concurred in the Tax Court's recognition of Bendix's commitment "to a corporate strategy of

international diversified growth" as a basis for finding Bendix a unitary business. The Appellate Division also affirmed the apportionment formula for the reasons expressed by the Tax Court. Bendix, relying on R. 2:2-1(a)(1), appealed to this Court as a matter of right, asserting a substantial question under the United States Constitution.

A.

Bendix is a Delaware corporation with its principal office in Southfield, Michigan. In 1929, Bendix incorporated in Delaware. At that time it manufactured aviation and automotive parts.

In 1937, Bendix qualified to do business in New Jersey. Its operations in this State essentially consist of the production of several aerospace flight, guidance and test systems in Teterboro and of the manufacture of electric power-generating systems in Eatontown. The specific activities of Bendix in New Jersey are carefully detailed in the Tax Court opinion. 10 N.J.Tax 46 (1988).

Bendix has grown to be a multi-jurisdictional corporation with activities through direct operation or affiliates in all fifty states and twenty-two foreign countries. According to the deposition of Agee, Bendix, from 1965 to 1981, sought to diversify the company's holdings and strengthen its operations. During that period, Bendix acquired either part or all of over forty separate companies. In the same period, Bendix sold off eight or more of its affiliates or divisions, including ASARCO and UGC.

Annual reports to stockholders during the growth period reflect a methodology of selective acquisitions and

divestitures of companies to foster corporate expansion in new areas or of existing business activities. The 1969 annual report to shareholders reflects the growth program in the statement, "we intensified our efforts to expand [from businesses dependent on the government sector] in other commercial and industrial markets." The same report states, "[a]cquisitions have played a significant role in the growth of your Corporation during the past decade." The report refers to six corporate acquisitions and four corporate sales during the year.

Each annual report thereafter trumpets Bendix's strategies to pursue diversification and growth in both domestic and foreign markets. By 1975 Bendix had followed a "careful diversification . . . into four broad lines of business—automotive, aerospace-electronics, industrial-energy and shelter." Those four lines under Agee's direction changed to automotive, aerospace-electronics, forest products, and industrial-energy, with all affiliates being assigned to one of those four major operating groups. The New Jersey divisions fell essentially into the aerospace-electronics and the industrial-energy groups.

The operating groups served as the basis for vertical corporate supervision. Generally, while each subsidiary had its own management, that management reported to the chief executive of its group. The group chief executive reported to the Bendix CEO, who also served as chairman of the board. In that way, the CEO maintained almost exclusive control and decision-making power over the entire corporation. In his deposition, Agee stated he made the final decision on all acquisitions and divestitures subject to board approval where required.

Bendix maintained a planning department to advise group managers and Agee on "long and short range business proposals." Those proposals analyzed capital commitments to existing as well as new business activities, analyzed divestiture of affiliates or operating units, and evaluated acquisition candidates. As one stipulation put it, "[w]hile acquisition or divestiture was not the sole means of accomplishing certain . . . objectives, Bendix . . . engaged in selected acquisitions and divestitures of companies or assets over the years."

Agee, in his deposition, described some of the planning department's responsibilities on the strategies of growth. He characterized one of the department's responsibilities as what it takes to grow with and without capital and, if with it, how much more. These strategy reviews dovetailed with Bendix's consideration of group managers' plans for making an acquisition "in order to remain competitive" or with the general corporate goal of expansion within the existing financial base or one entailing the "need [for] more money." The record discloses evidence from which one can reasonably conclude that such acquisition decisions entailed reliance on the cash flow from divestitures as a source of capital.

By 1977, under Agee's hand, diversification and expansion had become the by-word of corporate policy. The 1977 annual report states, "we have pursued a deliberate policy of diversification both within and among our lines of business, and geographically as well, in an effort to arrive at a combination of activities that helps insulate the company as a whole from the ups and downs of any one of them."

This theme in 1978 fostered a memorandum from Agee to Bendix's planning committee entitled *Long Range*

Growth and Acquisition Planning. For the 1980s, the memorandum recommended diversification in several areas to encourage corporate growth, "rebalancing," and restructuring of a Bendix division with an eye to divestiture. The memorandum discusses the effect acquisitions would have on "near-term earnings" and notes "each major acquisition would be structured to leave us positioned financially to take the next action."

The 1978 memorandum specifically discusses several acquisitions required for "strong growth in the 80's." One of those acquisitions was ASARCO.

B.

ASARCO's appeal to Bendix stemmed from ASARCO's profitable natural resource business, some of which occurred in New Jersey. The specific nature and extent of that business is described in *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103, 73 L.Ed.2d 787 (1982).

Agee's 1978 memorandum targeted ASARCO for acquisition. The memorandum reviewed the alternatives between total acquisition and 20% stock ownership. Agee opined that, even with a minority stock ownership, Bendix's influence would be "felt" with one or two seats on ASARCO's board of directors. Agee projected the minority membership would give Bendix "access to insider information which could inhibit but not bar further acquisition of shares."

By November 1978 Bendix owned 20.6% of ASARCO's stock. Bendix gained two seats on ASARCO's board in the persons of Agee and an outside director of Bendix. While an agreement negotiated with ASARCO

placed limits on Bendix's ability to acquire more stock and despite the absence of further stock acquisitions, Bendix benefited significantly from its minority ownership. In 1979, ASARCO contributed 82 cents per share to Bendix's total earnings of $7.10 per share. In 1980, ASARCO contributed $2.22 per share to Bendix's total earnings of $7.68 per share.

During the time Bendix owned 20.6% of ASARCO, the companies had limited interaction. They shared no common officers, employees, office space, or legal services. Neither company loaned money to the other nor did either guarantee debts of the other. Also, while ASARCO subsidiaries made small arms length sales to Bendix, the companies did not make direct sales to one another. Bendix kept ASARCO's activities under review through a quarterly examination of ASARCO's books and continuous scrutiny of ASARCO's earnings by Bendix's board of directors.

In October 1980, ASARCO agreed to purchase the Bendix shares. The purchase occurred in 1981, yielding a capital gain of approximately $211,500,000. According to Agee, Bendix sold the ASARCO stock as part of its plan for restructuring the company. Agee characterized the restructuring as an effort to move into the high technology field to make the entire company less dependent on the automobile business for profits and to sell off those aspects of the corporation that did not financially or otherwise fit the "mainstream" mold Bendix's decision makers sought. Agee projected the move into the high technology field as an opportunity to benefit and complement Bendix's New Jersey operations. Bendix placed the proceeds of the stock sale in a Lehman Brothers investment account commingling them with the UGC capital gain proceeds.

C.

Bendix had purchased 100% of UGC in 1965 as part of its acquisition program. The 1965 annual report to Bendix stockholders identifies the purchase as one beyond "[mere] diversification" and part of the enhancement and improvement of Bendix's competence in geophysical services to oil companies. UGC performs seismic surveying to locate oil and natural gas sources with none of the business conducted in New Jersey.

Bendix had selective integration or unity with UGC. Bendix made one of its corporate officers, Murray Weingarten, president of UGC for a four-year period. Weingarten reorganized UGC and placed two other Bendix employees in management positions. Weingarten reported regularly to Bendix superiors. After Bendix reassigned Weingarten, the president of UGC continued to report regularly to a Bendix corporate executive and group manager. During Bendix's ownership of UGC, the subsidiary had sixteen directors and thirteen officers with simultaneous or prior employment at Bendix. However, the companies did not share patents or technology nor did they sell goods to one another. They had separate pension plans, separate personnel manuals, and did not engage in centralized purchasing or banking. UGC also did not provide services to Bendix.

Management integration occurred in other significant areas. Bendix approved Weingarten's hiring and salary decisions. Bendix also approved UGC's annual financial and strategic plans, approved capital expenditures above certain dollar limits, and kept abreast of UGC's activities through periodic reports, joint management conferences, and regular eighteen-month audits. Bendix's management control also resulted in a

veto of a UGC effort to end its marine exploration program.

Other less significant integration occurred. Bendix guaranteed UGC's California workers' compensation plan, while UGC employees participated in Bendix's workers' compensation plans as well as certain employee savings and stock ownership plans. Bendix also provided some insurance, legal, and tax advice services for compensation.

Financially, Bendix also provided assistance to UGC. The parent company financed the construction of two $1,000,000 seismic exploration ships, made periodic working capital loans at market interest rates, and capitalized $11,100,000 of UGC debt to Bendix in 1978 and 1981, which eliminated UGC's fixed obligation to repay the debt.

The UGC divestiture occurred in July 1981. Reasoned essentially on the same grounds as the ASARCO divestiture, Bendix made a capital gain of approximately $41,900,000, the proceeds of which it deposited in the Lehman Brothers investment account.

D.

The capital gains proceeds from the ASARCO and UGC stock sales did not lie idle long. After earning approximately $3,400,000 in interest, Bendix used the proceeds for essentially two purposes—to repurchase 4,000,000 shares of outstanding Bendix stock and to contribute to the acquisition of 70% of Martin Marietta's stock.

The 1981 annual report described corporate ventures made possible by the divestiture-generated capital gains. Characterizing the ventures as "ambitious aspirations for the future," the report states:

> [O]ur redeployment of assets through our divestment program also contributed significantly to net income in 1981. We completed our plan for major divestments with the sales of [ASARCO and UGC].
>
> These major strategic actions converted approximately $500 million in lower-return assets into a liquid portfolio . . . .
>
> In addition, the effective execution of this asset redeployment program generated approximately $275 million in net gains . . . These gains allowed [repurchase of] some four million shares . . . which should enhance future shareholder value.
>
> . . . .
>
> We have the capability to expand or restructure our businesses through acquisitions and other investments. A three-pronged acquisition program is well under way. . . .
>
> [The second prong is] [r]esources will be available on a continuing basis to *finance natural extensions of our existing businesses.*
>
> [The third prong is] directed toward major businesses which could provide additional dimensions to the company. [emphasis added]

Agee indicated the investment or acquisition program was foremost in his mind. Asserting he made the decision to acquire Martin Marietta, Agee stated that Martin Marietta fit "very nicely" into the financial and operational strategies of the company. He described the Martin Marietta acquisition as "very complementary and compatible with Bendix." He noted Martin Marietta was a prime contractor in many cases, and Bendix was a subcontractor. That, he reasoned, made "a lot of our technology and management philosophies and businesses . . . complementary to one another."

Agee submitted a report to the Bendix board on the proposed acquisition of Martin Marietta. In that report Agee wrote:

> [O]ur commitment to the aerospace industry would be deepened [with the acquisition], strengthening our reputation as a reliable supplier to this nation's defense and that of its allies. . . .
>
> The combined company would be stronger financially, with about double Bendix's current profits and assets.

Bendix went forward with its purchase of 70% of the stock of Martin Marietta, but before Bendix could arrange a Martin Marietta stockholders meeting to complete the takeover, maneuvering by other corporations interfered with Agee's dream. Martin Marietta and Allied Signal bought up Bendix stock, which resulted in Bendix becoming a wholly owned subsidiary of Allied Signal.

II.

The unitary business/formula apportionment method has evolved as a constitutionally acceptable standard for resolving the problem of State taxation of multi-jurisdictional corporations doing business in the taxing State. *See Container Corp. of Am. v. Franchise Tax Bd., supra,* 463 U.S. at 165, 103 S.Ct. at 2940, 77 L.Ed.2d at 553. The method

> calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. [*Id.*]

The unitary business principle, characterized as the "linchpin of apportionability," provides the foundation to satisfy due process and commerce clause restraints. *See Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 439, 100 S.Ct. 1223, 1232, 63 L.Ed.2d 510, 522 (1980).

The due process and commerce clauses impose two restrictions on the authority of a State to tax income spawned by business activities of multi-jurisdictional corporations. First, there must he "a 'minimal connection' between the interstate activities and the taxing State." *See id.* at 436-37, 100 S.Ct. at 1231-32, 63 L.Ed.2d at 520 (quoting *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 273, 98 S.Ct. 2340, 2344, 57 L.Ed.2d 197, 204 (1978)). Second, there

must be a rational relationship between the income attributed to the State for tax purposes and the intrastate values of the corporate business. *See id.*, 445 U.S. at 437, 100 S.Ct. at 1231, 63 L.Ed.2d at 520. In other words, if the taxing State has some tie with the corporation's interstate business and it taxes only so much of the corporate income as bears a rational relation to activities the corporation conducts in the taxing State, the tax imposed comports with constitutional restraints.

Under the unitary business principle, the minimal contacts restraint is met if a multi-jurisdictional corporation is found to be a unitary business. The principle is that so long as a multi-jurisdictional corporation's "intrastate and extrastate activities form[]part of a single unitary business," the required minimum contacts exist that entitle the taxing State to an apportioned share of all the corporation's income. *See id.* at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521.

While the principle can be stated with ease, defining the scope of a unitary business is not as readily done. A series of United States Supreme Court opinions has shaped the defining process. *See Container Corp. of Am. v. Franchise Tax Bd., supra,* 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545; *F. W. Woolworth Co. v. Taxation & Revenue Dep't,* 458 U.S. 354, 102 S.Ct. 3128, 73 L.Ed.2d 819 (1982); *ASARCO Inc. v. Idaho State Tax Comm'n, supra,* 458 U.S. 307, 102 S.Ct. 3103, 73 L.Ed.2d 787; *Exxon Corp. v. Wisconsin Dep't of Revenue,* 447 U.S. 207, 100 S.Ct. 2109, 65 L.Ed.2d 66 (1980); *Mobil Oil Corp. v. Commissioner of Taxes, supra,* 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510; *Moorman Mfg. Co. v. Bair, supra,* 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197; *Butler Bros. v. McColgan,* 315 U.S. 501, 62 S.Ct. 701, 86 L.Ed. 991 (1942); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell,* 283 U.S. 123, 51 S.Ct. 385,

75 L.Ed. 879 (1931); *Bass, Ratcliff, & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 45 S.Ct. 82, 69 L.Ed. 282 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 41 S.Ct. 45, 65 L.Ed. 165 (1920); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 17 S.Ct. 305, 41 L.Ed. 683 (1897). In *Silent Hoist & Crane Co. v. Director, Division of Taxation, supra*, 100 N.J. 1, 494 A.2d 775, we thoroughly analyzed the scope of the holdings of those cases, and we need not repeat that analysis here. What bears repeating is the tenor of those holdings.

To begin with, substance not form dictates whether a unitary business exists. We must look at the underlying activities, the economic realities of the corporation, not the form in which the income is received or other vagaries of formalism. *See Mobil Oil Corp. v. Commissioner of Taxes, supra*, 445 U.S. at 440-41, 100 S.Ct. at 1233-34, 63 L.Ed.2d at 522-23. Those dictates make resolving the issue of whether a unitary business exists fact sensitive. As the Supreme Court noted in *ASARCO*, "these cases are decided on their facts in light of established general principles." 458 U.S. at 329 n. 24, 102 S.Ct. at 3116 n. 24, 73 L.Ed.2d at 803 n. 24.

The focus on facts or underlying activities and avoidance of reliance on form to determine the existence of a unitary business is necessary because of the intangible nature of corporate activities. As noted in *Exxon*, reliance on a particular form, in that case an accounting method, for resolving the issue may not comport with the facts a State needs when it "seeks to tax values created by business within its borders." 447 U.S. at 222, 100 S.Ct. at 2119, 65 L.Ed.2d at 80 (quoting *Butler Bros. v. McColgan, supra*, 315 U.S. at 507, 62 S.Ct. at 704, 86 L.Ed. at 996). That is so because a

> State in attempting to place upon a business extending into several States "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." [*Id.* (quoting *Underwood Typewriter Co. v. Chamberlain, supra*, 254 U.S. at 121, 41 S.Ct. at 47, 65 L.Ed. at 169).]

Consequently, the underlying economic realities as evidenced by the facts become the laser beam for resolving the unitary business issue. *See Container Corp. of Am. v. Franchise Tax Bd., supra*, 463 U.S. at 179-80, 103 S.Ct. at 2947-48, 77 L.Ed.2d at 562.

Consonant with the premise that the facts of each case govern is the Supreme Court's refusal to promulgate an exclusive test to evaluate whether a multi-jurisdictional corporation engages in a unitary business. The Court has steadfastly rejected any per se or bright line standard for defining a unitary business. *See id.* at 168, 178, 103 S.Ct. at 2941, 2947, 77 L.Ed.2d at 555, 561; *Exxon Corp. v. Wisconsin Dep't of Revenue, supra*, 447 U.S. at 221-22, 100 S.Ct. at 2119-20, 65 L.Ed.2d at 80; *Mobil Oil Corp. v. Commissioner of Taxes, supra*, 445 U.S. at 438-42, 100 S.Ct. at 1232-34, 63 L.Ed.2d at 521-24. As we stated in *Silent Hoist*, there is no single test for defining a unitary business. 100 N.J. at 18, 494 A.2d 775. Instead, there are a number of nonexclusive tests utilized to determine the existence of a unitary business.

Those tests concentrate on the intangible nature of a conglomerate's business activities that contribute to corporate income. In recognition of the fact that corporate income and profitability arise from the operation of a business as a whole, *see Mobil Oil Corp. v. Commissioner of Taxes, supra*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d

at 521, the existence of exchange or transfer of value has become the predicate for satisfaction of constitutional restraints. Justice Brennan, writing for the majority in *Container*, after identifying the principles required to satisfy due process and commerce clause restraints, explained:

> [T]he principles we have quoted require that the out-of-state activities of the purported "unitary business" be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation. [463 U.S. at 166, 103 S.Ct. at 2940, 77 L.Ed.2d at 554.]

Prior to *Container*, "unquantifiable transfers of value" emerged in circumstances in which corporate activities involved functional integration, centralization of management, and economies of scale. *See id.* at 164-65, 103 S.Ct. at 2939-40, 77 L.Ed.2d at 553. *See generally Mobil Oil Corp. v. Commissioner of Taxes, supra*, 445 U.S. at 438-39, 100 S.Ct. at 1232-33, 63 L.Ed.2d at 521; *Butler Bros. v. McColgan, supra*, 315 U.S. at 508-09, 62 S.Ct. at 704-705, 86 L.Ed. at 996-97. Thus, the context for determining whether a unitary business exists has, as an overriding consideration, the exchange or transfer of value, which may be evidenced by functional integration, centralization of management, and economies of scale.

In applying the tests the Supreme Court has concentrated on the relationship between the multi-

jurisdictional taxpayer parent and the affiliate when the latter pays to the parent, usually in the form of dividends, the income that is subjected to a State's apportionment tax. That concentration is pertinent here concerning UGC.

UGC was in a unitary relationship with Bendix. Bendix provided a president, other management personnel, and corporate directors from its ranks. That filling of personnel needs reflects a unitary relationship. Bendix controlled certain hiring and salary decisions of UGC's president. The president reported directly and regularly to executive and management personnel in charge of the Bendix group covering UGC's business activities. That, along with the veto of UGC's effort to terminate its marine exploration program, evidence a supervisory role exemplifying a functionally integrated enterprise illustrative of a unitary business. *See Container Corp. of Am. v. Franchise Tax Bd., supra*, 463 U.S. at 179, 103 S.Ct. at 2947, 77 L.Ed.2d at 562.

Other evidence of a unitary relationship exists. Bendix participated in UGC financial matters, which went well beyond the occasional supervision described in *F. W. Woolworth*. Bendix approved annual financial plans and expenditures over a certain dollar amount, financed ship construction, and capitalized an $11,100,000 debt that eliminated UGC's fixed obligation to repay the debt. Such conduct reflects a "flow of value" that evidences a unitary relationship.

Other Bendix activities existed that, when combined with the foregoing, suggest a unitary business. UGC employees had workers' compensation coverage under Bendix plans, as well as participation in employee savings plans. Bendix provided technical assistance, although for compensation, in the insurance, legal, and

tax fields. While such activities alone may not rise to the level of proof of a unitary business, in context with Bendix's functional and personnel integration with UGC, they lead to the conclusion that a unitary business existed.

The tests for determining a unitary business are not controlled, however, by the relationship between the taxpayer recipient and the affiliate generator of the income that becomes the subject of State tax. As has been emphasized, there is no bright line controlling test. What controls is the underlying activities that reflect the economic realities of the corporate business. In that perspective, the intangible nature of corporate operations is assessed to determine the existence of a unitary business.

From that perspective, we are satisfied the capital gains from the sale of stock in both UGC and ASARCO are apportionable under the unitary business principle. Bendix had an ingrained acquisition-divestiture policy designed to expand and enhance its existing operations as well as to move it into other fields of business. The long-term planning strategy encompassed a process focused on acquisitions, disposition of unwanted affiliates or divisions, and development of sources of capital for new acquisitions. The divestitures served at times as the capital sources for acquisitions. The strategy went well beyond the passive investments in business enterprises referenced in *Container* that are distinct from the corporation's main line of business and that have the sole primary function of diversifying the corporate portfolio and reducing risks inherent in being tied to one industry's business cycle. *See id.* at 178, 103 S.Ct. at 2947, 77 L.Ed.2d at 561. Bendix, during the period under review, essentially had a business function of corporate

acquisitions and divestitures that was an integral operational activity. That function went well beyond the nature of the investment processes in *ASARCO* and *F. W. Woolworth* that the Supreme Court found so wanting in unitary business characteristics. The investment policy did more than simply earn money to continue operations and provide a return on its capital. That is indicated, in part, by the 1981 annual report, which when referencing the capital gains from the ASARCO and UGC stock sales states those sales provided the "liquid portfolio" and provided the resource to finance "natural extensions of Bendix's existing business." That those sales were more than occasional events is mirrored by the long-term policy of continued acquisitions and divestitures, with the latter serving as a means to make the former.

When capital investment activities are long-term integral operational corporate functions rather than passive investment functions, they can serve as the basis for concluding a unitary business exists. *Cf. Container Corp. of Am. v. Franchise Tax Bd., supra,* 463 U.S. at 180 n. 19, 103 S.Ct. at 2948 n. 19, 77 L.Ed.2d at 562 (citing *Corn Prods. Ref. Co. v. Commissioner,* 350 U.S. 46, 50-53, 76 S.Ct. 20, 23-25, 100 L.Ed. 29, 34-36 (1955)). In *Corn Products,* the Supreme Court held that income gains and losses that resulted from a corn products manufacturer's purchase of and sale of corn futures constituted ordinary income rather than capital gains for tax purposes. While the ruling arose in another context, we read it as support for the conclusion we reach today.

When the investments in affiliates that generate capital gains become an integral part of a corporation's business, such that they go beyond the passive corporate investment and have as their goals the growth and expansion of existing corporate business activities rather

than just the providing of return on capital, a basis is established for making the income from those capital gains subject to a State's apportionable tax formula. *Cf. Silent Hoist & Crane Co. v. Director, Div. of Taxation, supra,* 100 N.J. at 21-22, 494 A.2d 775. Such an investment policy reflects an ordinary business practice that goes beyond the focus on the distinct nature of the affiliate's business and beyond the focus on the existence of a functional relationship or managerial relationship between the taxpayer and the affiliate. *See generally Hellerstein, State Income Taxation of Multijurisdictional Corporations and the Supreme Court,* 35 Nat'l Tax J. 401, 417 (1982). It is a policy that involves more than the concept argued by the taxing State in *ASARCO,* and found so wanting by the Supreme Court, that any intangible income should make a business unitary if it is acquired for "purposes relating or contributing to the taxpayer's business." *See ASARCO Inc. v. Idaho State Tax Comm'n, supra,* 458 U.S. at 326, 102 S.Ct. at 3114, 73 L.Ed.2d at 801. It is also a policy that creates the nexus and rational relationship required to satisfy constitutional restraints. *See Container Corp. of Am. v. Franchise Tax Bd., supra,* 463 U.S. at 165, 103 S.Ct. at 2940, 77 L.Ed.2d at 553.

Some of the evidence required to satisfy those constitutional restraints came from Agee's deposition testimony. Agee testified that the purpose of acquiring Martin Marietta was to complement the aerospace-electronics facets of Bendix business, some of which are located in New Jersey. Agee foresaw the complement in the fact that Martin Marietta's dominance in the aerospace field would enhance the theretofore subordinate or limited activity of Bendix in that field. While the nature of that complement is intangible, it suggests a flow of value analogous to, although different in focus

from, that recognized in *Container* for finding a unitary business. *Cf. id.* at 166, 103 S.Ct. at 2940, 77 L.Ed.2d at 554.

Even though the Martin Marietta takeover never came to fruition, the fact that it served as a goal for part of the capital generated by the sales of ASARCO and UGC stock nurtures the premise that Bendix's ingrained policy of acquisitions and divestitures projected the existence of a unitary business. The nature of that policy as effectuated demonstrates the presence of a unitary business. The policy also precludes Bendix from meeting its "distinct burden of showing by 'clear and cogent evidence' that [the State tax] results in extraterritorial values being taxed." *Exxon Corp. v. Wisconsin Dep't of Revenue, supra,* 447 U.S. at 221, 100 S.Ct. at 2119, 65 L.Ed.2d at 80.

Contrary to Bendix's assertion, the holdings of *ASARCO* and *F. W. Woolworth* do not dictate a reversal of the decision of the Appellate Division. Both *ASARCO* and *F. W. Woolworth* are factually distinguishable. ASARCO's stock investments were "not integral to nor a necessary part of [ASARCO's] business operation." *ASARCO Inc. v. Idaho State Tax Comm'n, supra,* 458 U.S. at 324 n. 21, 102 S.Ct. at 3113, n. 21, 73 L.Ed.2d at 800 n. 21 (quoting the jurisdictional statement). Also, ASARCO did not use "its stock as security for borrowing of working capital [to] acquire stock or securities in other companies." *Id.* Beyond that, neither *ASARCO* nor *F. W. Woolworth* involved the purchase of 4,000,000 shares of outstanding corporate stock to enhance the stockholder value in the corporation. Also, in neither *ASARCO* nor *F. W. Woolworth* did the taxing State produce any facts that demonstrated the minimal contacts and rational relationships required to satisfy constitutional restraints.

Those differences preclude *ASARCO* and *F. W. Woolworth* from controlling here.

In sum, all the capital gains here are income derived from an activity that is integrally related to the conduct of a unitary business. Consequently, it is unitary business income that is subject to apportionment. Moreover, the UGC capital gains are income derived from an asset that is integrally related to a unitary business and similarly taxable. The economic realities of Bendix's corporate activity demonstrate New Jersey's apportioned tax on the capital gains and related interest satisfy all constitutional restraints.

III.

We turn now to Bendix's alternative argument that "an adjustment to Bendix's allocation factor is required" pursuant to N.J.S.A. 54:10A-8. Bendix contends that we should require the Director to modify the apportionment formula to include the property, sales, and payrolls of ASARCO and UGC to the extent of Bendix's percentage of stock ownership in those companies. *See Silent Hoist & Crane Co. v. Director, Div. of Taxation, supra*, 100 N.J. at 11-14, 494 A.2d 775 (explaining New Jersey's tax apportionment formula).

Bendix's principal argument is that "[a]part from constitutional considerations," the Director abused his discretion in denying Bendix's request for an adjustment to its allocation factor under N.J.S.A. 54:10A-8. We do not view that to be a substantial constitutional issue for which R. 2:2-1(a)(1) affords a right of appeal to this Court. *See Piscataway Assocs. v. Township of Piscataway*, 73 N.J. 546, 549, 376 A.2d 527 (1977). Therefore, we decline to consider that argument.

To the extent Bendix suggests an issue of constitutional dimension, we conclude, as did the Tax Court and Appellate Division, Bendix failed to meet its burden of proof. Bendix argues the apportionment formula utilized does not actually reflect a reasonable sense of how the income was generated, relying on *Container, supra,* 463 U.S. at 169, 103 S.Ct. at 2942, 77 L.Ed.2d at 556. Bendix, however, made no actual demonstration of unfairness and instead relied upon notional assertions. As we stated in *United States Steel Corp. v. Director, Division of Taxation,* 38 N.J. 533, 547, 186 A.2d 266 (1962):

> The most that has been shown is that a tax upon a modification of the statutory formula would be less than upon the formula as written. That hardly proves that the formula in fact allocated to New Jersey any extraterritorial property or activity, let alone so much as would meet the exacting test of a palpable misapportionment.

We are required to strike down an apportionment formula only when the taxpayer establishes by clear and cogent evidence that there is no rational relationship between the income attributed to the State and the intrastate values of the corporation by proving that the apportioned income is out of all appropriate proportion to the business the taxpayer transacts in the State. *See Container Corp. of Am. v. Franchise Tax Bd., supra,* 463 U.S. at 170, 180-81, 103 S.Ct. at 2942, 2948-49, 77 L.Ed.2d at 556, 563. We are not required to disturb an apportionment formula so long as the State, in applying the formula to a unitary business taxpayer's total income, obtains a "'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing State.'" *See Exxon Corp. v. Wisconsin*

Dep't of Revenue, supra, 447 U.S. at 223, 100 S.Ct. at 2120, 65 L.Ed.2d at 81 (quoting *Moorman Mfg. Co. v. Bair, supra*, 437 U.S. at 273, 98 S.Ct. at 2344, 57 L.Ed.2d at 204). We find no evidence in the record to establish the required distortions or absence of reasonable relationship. Bendix has not sustained its burden of proof.

IV.

We would be remiss were we not to make one final observation. Cases of this nature are the quintessential example of the tenet that facts, not principles of law, decide cases. *See Feldman v. Lederle Laboratories*, 97 N.J. 429, 455, 479 A.2d 374 (1984) (citing *Konrad v. Anheuser-Busch, Inc.*, 48 N.J. Super. 386, 388, 137 A.2d 633 (Law Div. 1958)). Our decision today should not be read beyond the scope of the facts of the case.

Affirmed.

APPENDIX B

BENDIX CORPORATION,
Plaintiff-Appellant,
v.
DIRECTOR, DIVISION OF TAXATION,
Defendant-Respondent.

Superior Court of New Jersey, Appellate Division.

Argued May 22, 1989.
Decided Oct. 19, 1989.

Before Judges DEIGHAN, BAIME AND D'ANNUNZIO.

The opinion of the court was delivered by

D'ANNUNZIO, J.A.D.

Bendix Corporation (Bendix) appeals a Tax Court judgment affirming a Division of Taxation decision to add three income items to Bendix's income for its fiscal year which ended September 30, 1981. *Bendix Corp. v. Taxation Div. Director*, 10 N.J.Tax 46 (1988). The three items are:

(1) a $ 211.5 million capital gain from Bendix's sale of 20.6% of the outstanding stock of Asarco, Inc. (Asarco);

(2) a $ 41.9 million capital gain from Bendix's sale of 100% of the outstanding stock of United Geophysical Corporation (UGC); and

(3) $ 3.4 million interest Bendix earned on the proceeds of the Asarco and UGC stock sales.

The addition of these items increased Bendix's tax base under New Jersey's Corporation Business Tax Act (1945), N.J.S.A. 54:10A-1 *et seq.*, and, therefore, increased Bendix's tax.

I. BASIC FACTS

The facts are not in dispute as the case was tried on stipulated facts and exhibits and a deposition of W.M. Agee, a former Bendix chief executive.

During the tax year in question, Bendix was a Delaware corporation, incorporated in 1929, with its principal office in Michigan. Bendix commenced business as a manufacturer of aviation and automotive parts. By 1981 Bendix was a multinational corporation operating directly or through subsidiaries in all 50 states and 22 other countries, and its business had expanded beyond basic aviation and automotive business to include four major operating groups: (a) automotive; (b) aerospace/electronics; (c) industrial energy; (d) forest products.

In 1981, Bendix operated several units of its aerospace group in Teterboro, New Jersey, and manufactured electric generating systems in Eatontown, New Jersey. In addition, a wholly owned subsidiary, Bendix's Field Engineering Corporation, provided ocean current, weather and other information worldwide to the

trans-oceanic shipping industry through its Marine Science Services Division in Teterboro and provided facilities management and support services to an Environmental Protection Agency facility in Edison, New Jersey. Bendix sold its full range of products and services to New Jersey customers and stored inventory in New Jersey.

Bendix acquired 20.6% of Asarco's outstanding stock between December 1977 and November 1978. Asarco mined and produced copper, lead, zinc, silver and other non-ferrous metals, as well as asbestos and coal, in Latin America and other countries. *See ASARCO Inc. v. Idaho State Tax Comm'n.*, 458 U.S. 307, 102 S.Ct. 3103, 73 L.Ed.2d 787 (1982) for a more detailed description of Asarco's activities. As a result of its equity position in Asarco, two Bendix executives became members of Asarco's 14-member board of directors. Asarco contributed $.82 a share to Bendix's 1979 earnings of $ 7.10 a share, and $ 2.22 a share to Bendix's 1980 earnings of $ 7.68 a share.

In late 1980, Bendix decided to sell its Asarco stock because it had appreciated considerably and Bendix had decided to reduce its position in the natural resource business. The sale yielded three times Bendix's initial investment.

In 1965, Bendix purchased all of the stock of United Geophysical Corporation (UGC). UGC performed seismic surveys for the oil and gas industry. UGC transacted no business in New Jersey. Bendix employees managed UGC through service on UGC's board or as UGC corporate officers. Bendix approved UGC's annual financial plans, its major capital expenditures and

financed the construction of two ships to be used by UGC in marine seismic exploration.

In 1980, Bendix took advantage of an opportunity "to divest UGC at a very favorable price" and sold all of the UGC stock for $ 80 million, yielding a $41.9 million capital gain.

In 1981, Bendix placed the proceeds of the Asarco and UGC sales in an interest bearing investment account outside New Jersey. The investments generally carried maturities of less than 90 days and generated $ 3.4 million interest during fiscal 1981.

Bendix contends that New Jersey's inclusion of the Asarco and UGC capital gains in the corporate business tax base was an unconstitutional taxing of extra-territorial values.

II. PRINCIPLES OF LAW

A state may look beyond its borders in taxing the property of foreign corporations to allow it to

> get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess. [*Wallace v. Hines*, 253 U.S. 66, 69, 40 S.Ct. 435, 436, 64 L.Ed. 782 (1920)].

This principle was applied in *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271, 45 S.Ct. 82, 69 L.Ed. 282 (1924), to uphold a New York franchise tax imposed on an English brewer.

> So in the present case we are of the opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions, beginning with the manufacture in England and ending in the sales in New York and other places . . . the state was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business. [*Id.* at 282, 45 S.Ct. at 84].

Because the taxpayer's New York activities were part of the "unitary business" of brewing and marketing ale, New York taxing authorities were permitted to measure the tax base by all of the taxpayer's worldwide income. This base was then apportioned to New York by the proportion the value of the taxpayer's New York property bore to the total value of all the taxpayer's property ($ 44,117/$ 3,501,483).

The unitary business principle was considered recently by the United States Supreme Court in a series of cases beginning in 1980. In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510 (1980), the Court upheld Vermont's inclusion in Mobil's tax base of dividends Mobil received from its subsidiaries and affiliates doing business abroad. Mobil was a New York corporation which marketed petroleum products in Vermont. Mobil had no production or refining facilities in Vermont.

The Court stated the general principle that to tax income generated in interstate commerce Due Process requires a minimal connection between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the

intrastate values of the enterprise. The Court ruled that Mobil failed to establish that the income was earned in the course of activities unrelated to the sale of petroleum products in Vermont. It was satisfied that the foreign activities were part of Mobil's integrated petroleum enterprise.

> So long as dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business. One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability. [*Id.* at 440, 100 S.Ct. at 1233.]

In *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 100 S.Ct. 2109, 65 L.Ed.2d 66 (1980), the Court rejected Exxon's argument that its maintenance of three discrete departments for Exploration/Production, Refining and Marketing, each with separate financial accounts, required the exclusion of non-marketing income from its Wisconsin tax base.

Mobil and *Exxon* involved vertically integrated economic units. *ASARCO Inc. v. Idaho State Tax Commission, supra*, involved dividend and interest income from corporations in which Asarco owned major interests but which engaged in the same business as Asarco, the mining and production of non-ferous metals. Although there was some movement of product between Asarco and the subsidiaries, the corporate relationships more closely resembled a horizontal combination. Asarco's stock interests in the five subsidiary corporations ranged from 34% to 53%.

Silver mining was Asarco's principal Idaho activity, although it mined and sold other Idaho minerals and operated its northwest mining division's administrative office in Idaho. Only 2.5% of Asarco's total business activity occurred in Idaho. The subsidiaries were not active in Idaho.

The court rejected Idaho's contention that income from intangible property is part of a unitary business if it contributes to or furthers the taxpayer's business.

> This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. [*Id.*, 458 U.S. at 326, 102 S.Ct. at 3114.]

The Court applied a similar rationale to defeat the inclusion of a subsidiary's dividend in *F.W. Woolworth Co. v. Taxation & Rev. Dept.*, 458 U.S. 354, 102 S.Ct. 3128, 73 L.Ed.2d 819 (1982). Three of the subsidiaries were wholly owned; Woolworth owned 52% of the fourth subsidiary. Each subsidiary operated in a different country outside the United States, and each was in the same business as the parent, chainstore retailing of a variety of consumer goods. There was no centralized management and each subsidiary enjoyed business autonomy.

Asarco and *F.W. Woolworth* cast a dark shadow over the Tax Court's decision in the present case. However, their precedential value was weakened by the Court's subsequent decision in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545 (1983). Moreover, *Asarco* and *Woolworth*, like *Mobil* and *Exxon*, were single-industry companies, unlike Bendix.

Container Corporation of America (hereafter Container Corp.) was a vertically integrated manufacturer of paperboard packaging operating in the United States. It as a Delaware corporation headquartered in Illinois, and did business in California, the taxing state. Container Corp. controlled 20 foreign subsidiaries, located in Latin America and Europe, through stock ownership ranging between 66% and 100%. For the most part, these subsidiaries were fully integrated paperboard manufacturers enjoying autonomy "with respect to matters of personnel and day-to-day management." *Id.*, 463 U.S. at 172, 103 S.Ct. at 2943. No more than 1% of the subsidiaries' material purchases were from Container Corp.

The court reaffirmed the unitary business principle, but, despite substantial similarities with the facts in *Asarco* and *F.W. Woolworth*, the Court upheld the inclusion of the subsidiaries' income in Container Corp.'s franchise tax base. The Court distinguished *Asarco* and *F.W. Woolworth* in the following terms:

> The state Court of Appeal relied on a large number of factors in reaching its judgment that appellant and its foreign subsidiaries constituted a unitary business. These included appellant's assistance to its

> subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the "considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion," . . . the "substantial" technical assistance provided by appellant to the subsidiaries, . . . and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. In each of these respects, this case differs from ASARCO and F.W. Woolworth, and clearly comes closer than those cases did to presenting a "functionally integrated enterprise," . . . which the State is entitled to tax as a single entity. We need not decide whether any one of these factors would be sufficient as a constitutional matter to prove the existence of a unitary business. Taken in combination, at least, they clearly demonstrate that the state court reached a conclusion "within the realm of permissible judgment." [Id. at 179-180, 103 S.Ct. at 2947-2948; citations and footnotes omitted.]

The Court recognized that application of the unitary business principle was excruciatingly fact sensitive, and as long as the correct legal standard was applied, the Court limited its role to determining whether the state court's judgment "was within the realm of permissible judgment." *Id.* at 176, 103 S.Ct. at 2946. The Court cautioned, however, that "the mere flow of funds arising out of a passive investment or a distinct business operation," *id.* at 166, 103 S.Ct. at 2940, was not enough to relate a taxpayer's out-of-state activities "in some concrete way to the in-State activities." *Ibid.* What is

required is "some sharing or exchange of value not capable of precise identification or measurement . . . which renders formula apportionment a reasonable method of taxation." Ibid.

III. THE TAX COURTS DECISION

The Tax Court in the present case distinguished between capital gains from the sale of an interest in a subsidiary corporation and dividends paid by a subsidiary. According to the Tax Court, in a capital gains context, such as this case, the focus must be on Bendix's income and activities, and not on how Asarco or UGB earned its income. "The activities in issue are investment activities, and the unitary business question is resolved . . . by examining taxpayer's activities in managing the investment, not the nature of the activities of the subject of the investment." 10 N.J.Tax at 59. After examining Bendix's involvement in Asarco, the Tax Court concluded that Due Process did not preclude inclusion of the Asarco capital gain in Bendix's tax base because Bendix's Asarco investment was "a significant part of the Bendix corporate strategy." *Ibid.*

> The purchase of a minority share in Asarco was part of a Bendix plan for growth and diversification in the 1980's which called for investing in depressed and undervalued basic resources to achieve the planned result of a stronger, diversified company. This investment was made only after a thorough analysis of the copper industry and the qualities of specific acquisition candidates. The Asarco investment was part of a well-orchestrated corporate strategy designed to enhance Bendix's current status, as well as position Bendix for the future. To describe this investment as

> passive would ignore the New Jersey Supreme Court's decision in *Silent Hoist* and disregard economic reality. The determination of the New Jersey Supreme Court in *Silent Hoist* has set the course for this court to follow. [10 N.J.Tax at 59-60.]

Silent Hoist & Crane v. Taxation Div. Director, 100 N.J. 1, 494 A.2d 775 (1985), heavily relied upon by the Tax Court in this case, involved a New York corporation with its principal place of business in New York. It sold cranes in New Jersey, but its manufacturing plant was in New York. It also owned two commercial properties in New Jersey and had passive investment income. The Supreme Court reversed a Tax Court decision that the taxpayer's investment, real estate and sales businesses were distinct business enterprises and should not be taxed as a unitary business.

Although we do not fully subscribe to the legal significance attached to the distinction between dividends and capital gains, and despite the obvious factual differences between *Silent Hoist*, a one-man corporation, and the present case, we agree in general with the Tax Courts approach. By 1981 Bendix had developed beyond its root business of manufacturing aviation and automotive equipment to become a diversified international corporation. The Tax Court's opinion recognized that by 1981 Bendix was committed to a corporate strategy of international diversified growth. The record establishes that Bendix acquired assets based on their fit within the framework of existing Bendix operations and their utility as stepping stones to additional acquisitions, and not merely for their capacity to generate income.

IV. THE RECORD IN DETAIL

As previously indicated, the Tax Court decided this case on a stipulation of facts, the stipulated deposition of W.M. Agee (Agee), Bendix's CEO from January 1977 to June 1983, and on stipulated exhibits. The factual stipulation consists of 165 numbered paragraphs totaling 45 pages. The exhibits, lettered A through U, total 370 pages. Agee's deposition is 123 pages. The Tax Court's opinion referred only to the basic facts. Some of the details give a much better picture of Bendix and its goals.

Bendix maintained a planning department which "considered, analyzed and developed long and short range business proposals . . ." Stip., para. 27.

> Consistent with this objective, the planning department would analyze trends in the types of businesses Bendix was engaged in and ways to respond to those trends such as (i) increasing or decreasing capital commitment to particular product or services, (ii) greater or lesser expenditures by Bendix on research and development as to particular products or services, (iii) offering new or discontinuing (by divestiture of subsidiaries or other operating units or otherwise) existing Bendix products or services, or (iv) entry into a new product or service area either by developing the new product or service from within or by acquiring the assets, employees or technology for that new product or service through acquisition. The Bendix planning department, as the need arose, also evaluated acquisition candidates. *While acquisition or divestiture was not the sole means of accomplishing certain of the above-mentioned*

> *objectives, Bendix, as many other major corporations, engaged in selected acquisitions and divestitures of companies or assets over the years.* [Stip., para 27; Emphasis supplied.]
>
> 28. As described by A. Matthew Lord, Director of Corporate Development in the Bendix planning department, during his tenure in the planning department (1975-1982) Bendix had three major strategies for growth: (1) exploit its existing businesses, (2) move into related areas, and (3) move into unrelated areas with strong growth potential. [Stip., para. 28.]

In the late 1970's Bendix turned its attention, in part, to the acquisition of a natural resource company. On March 31, 1978, Agee addressed a lengthy memorandum to Bendix's *Long Range Planning Committee entitled Long Range Growth and Acquisition Planning*. (Exhibit E.) Initially, Agee defined some corporate goals for the next decade.

> We believe ourselves to be strong enough financially and managerially to warrant several major moves aimed at growth and diversification for the 80's.
>
> * Growth and diversification in the Industrial/Energy area.
>
> * Growth and rebalancing in the forest products area.
>
> * Investment in other basic resources that are now depressed and undervalued but that offer strong profit possibilities for the 80's.

* Restructuring of Bendix Home Systems with a view to possible withdrawal in the next few years.

Agee then described the potential impact of attaining these goals:

> These actions might slow down somewhat the growth in our near-term earnings. But we would be building towards rapid growth in earnings in the early 80's.
>
> We would be tilting our activities in the directions that may, on the whole, make us somewhat more cyclical than we have been but with compensating higher growth.
>
> We would be well able over the period to keep our balance sheet within the 65/35 ratio that is so important for us. Each major acquisition would be structured to leave us positioned financially to take the next action.
>
> We would probably face a significant increase in goodwill from acquisitions, but it is not entirely clear that this is so. We would have no trouble in maintaining our growth in dividends.
>
> The program that we have in mind would require some significant increase in our total capitalization. Part of this would come about in any case because we will generate an annual increase in net worth averaging approximately $ 100 million over the next five years. Leveraging this to the 2:1 debt ratio with which we are comfortable permits an increase in capitalization of over $ 300 million in the next two years and well

> over $ 750 million over 5 years. The use of preferred securities for acquisitions would, of course, strengthen our equity base thus permitting further debt. The sale of common stock is also open to us.

These observations underscored the interdependence of Bendix's existing businesses and long-term strategic planning. Agee also noted the positive relationship between acquisitions and growth "If we are to find strong growth in the 80's, acquisitions must be made. As noted before, we have the financial means for doing so." One of the acquisitions discussed in Agee's memorandum is that of Asarco, referred to by the code name Blackie. Agee expressed interest in acquiring a mining company "because we are bullish on basic resources for the balance of the century."

Agee's memorandum described Blackie and discussed alternative methods of acquisition from a purchase of 100% of its stock to acquiring a 20% interest which would permit earnings consolidation. Agee expressed a preference for the 20% position because financially it was more manageable and would give Bendix "time to become more familiar with the company and the industry *before chancing a significantly larger position*." [Emphasis supplied.] Moreover,

> On the matter of control. It does not follow that our influence in the company is only nominal because we would lack 51%. If we were to enjoy a good relationship with Blackie—with a seat or two on the Board—our influence could be felt. Much would depend, of course, on whether Blackie resisted or accepted our presence—about which more is said later. Even if it [***20] initially resisted, in due course it could

come around to accept if not welcome our presence and advice.

. . . .

Assuming success, what would happen next? We would organize ourselves to form a shadow group here to learn as much as we can about the company and the industry. If our nominees entered Blackie's Board, we would gain access to insider information which could inhibit but not bar further acquisition of shares. Within a time that cannot now be defined, we would decide on whether to enlarge or sell our holdings and, if so, how to do so. It is our intention not to let the matter dawdle. [Emphasis supplied.]

Agee's memorandum was followed by his April 12, 1978 recommendation to Bendix's Board of Directors that Bendix acquire up to 20% of Asarco's stock. Agee expressed the following reasons for his recommendation:

This acquisition clearly will aid us in our acquisition strategies whose purposes are:

* Reducing our dependence on the relatively slow-growing aerospace and automotive OEM market.

* Broadening our Industrial/Energy Group to give it size and better definition.

* Generating good cash flow in the early 1980's to meet growing capital needs, particularly in aerospace/electronics to permit it to hold its own in stiffening markets.

* Broadening our holding in basic commodities, particularly forest products and in non-fuel minerals that should prosper from the energy problem or which have other reasons for strong market position in the 1980's.

ASARCO clearly meets the last objective. We have actively in mind acquisitions in the forest products and industrial areas which we hope to bring to the Board in the not too distant future.

The Board approved the recommendations. Bendix paid $ 127,649.017 for the stock. It borrowed $ 110 million and paid the balance with internally generated cash.

In September 1979, Agee, with the approval of Bendix's Board, proposed a merger of Bendix and Asarco. Asarco's Board of Directors resisted and the matter was not pursued.

V. BENDIX ACQUISITION HISTORY

Bendix's Asarco acquisition was not an isolated event. It was part of a long-range acquisition policy described in paragraphs 130-153 of the stipulation.

In 1966, Bendix acquired seven companies, including one which produced medical electronics equipment for physicians and a company which produced fiber optics. Bendix acquired five companies in 1967 and five companies in 1968.

Bendix's 1969 Annual Report to Shareholders stated:

> Recognizing the vital necessity to broaden the base of our business so as to be less dependent on the government sector, we intensified our efforts to expand in other commercial and industrial markets.
>
> . . . . .
>
> Acquisitions have played a significant role in the growth of your corporation during the past decade.

Bendix made six acquisitions in 1969, including the Skagit Corporation which was involved in "logging equipment and systems and other handling equipment." Paragraph 130 of the stipulation describes the Skagit acquisition as "an acquisition in business areas in which [Bendix] had no existing specific involvement."

In 1970, Bendix merged with American Forest Products Corporation, which was described as Bendix's largest acquisition to date and "represented a new market for Bendix." American Forest Products Corporation was in the timber management, lumber, building materials, wood and corrugated containers, and aluminum siding businesses.

Bendix acquired six "relatively small" companies in 1971 and acquired a 50% interest in two European companies.

The 1972 Annual Report to Shareholders included a statement by Bendix's chairman that Bendix was pursuing "broad corporate strategies to further increase the non-government segment of our business, to pursue the diversification of our major lines of business, to

expand our role in non-cyclical or counter-cyclical markets and to increase our international involvement."

In 1973, Bendix acquired Boise Cascade's International Mobile Home and Recreational Vehicle businesses, reorganizing them as Bendix Home Systems. The 1973 Annual Report to Shareholders stated that Bendix "continued our policy of disposing of minor operations which do not relate to our long-range business strategy."

In 1976 Annual Report noted that Bendix's earning record in the 50's and 60's was "spotty" because of dependence on government work and on "the cyclical ups and downs of the industries [Bendix] served."

The 1977 Annual Report stated that "we have pursued a deliberate policy of diversification both within and among our lines of business, and geographically as well, *in an effort to arrive at a combination of activities that helps insulate the company as a whole from the ups and downs of any one of them.*" [Emphasis supplied.] This theme was repeated in the 1978 Annual Report in which the chairman noted that Bendix has "successfully pursued a strategy of diversification which has brought us resistance to the ill effects of swings in the business cycle. First, we are in four major businesses: automotive, aerospace-electronics, forest products and industrial-energy. Second, within each of these, we are all diversified."

This brief history demonstrates an acquisition policy focused, in part, upon diversification designed to reduce reliance on government work and to moderate the business cycle's impact. Bendix's Asarco acquisition was consistent with and furthered this policy and the record

supports a finding, implied in the Tax Court's decision, that Bendix's unitary business included implementation of this policy of acquiring interests in diverse industries to achieve the goals of growth, cyclical protection and corporate balance. *But see, James v. International Telephone and Telegraph Corp.*, 654 S.W.2d 865 (Mo. 1983), which rejected a similar unitary business analysis.

A similar analysis applies to UGC. Moreover, Bendix owned 100% of UGC and was directly involved in its management, capital financing and operations.

For the reasons above stated, we conclude that the capital gains earned from the sales of Asarco and UGC stock were properly included in Bendix's New Jersey tax base.

The Tax Court's inclusion in the tax base of the interest Bendix earned on the sale proceeds and the Tax Court's rejection of Bendix's attack on the allocation formula are affirmed for the reasons expressed by the Tax Court.

APPENDIX C

BENDIX CORPORATION,
Plaintiff,
v.
TAXATION DIV. DIRECTOR,
Defendant.

14-24-0504-84CB

Tax Court of New Jersey

June 30, 1988

LASSER, P.J.T.C.

Plaintiff, Bendix Corporation ("Bendix"), contests a corporation business tax (N.J.S.A. 54:10A-1 et seq.) deficiency assessment resulting from the addition by the Director, Division of Taxation, of three items of income to Bendix's income for its fiscal year ended September 30, 1981. Bendix contends that this income was not earned as part of Bendix's unitary business, and that the Director's inclusion of these items violates the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

The three items of income which Bendix claims may not constitutionally be included by the Director in the income tax measure of its corporation business tax liability are:

(a) capital gain of approximately $211.5 million realized on Bendix's sale of its 20.6% stock interest in Asarco, Inc. ("Asarco");

(b) capital gain of approximately $41.9 million realized on Bendix's sale of the stock in its wholly-owned subsidiary, United Geophysical Corporation ("UGC"); and

(c) interest of approximately $3.4 million earned on the proceeds of the sale of Bendix's interest in Asarco and UGC.

In the event the court determines that these items of income are properly includable, Bendix seeks an adjustment of the fiscal 1981 allocation factor in accordance with N.J.S.A. 54:10A-8, contending that the statutory allocation factor used by the Director does not reflect the receipts, payroll or property of Asarco and UGC. Director denies that the assessment is either improper or unconstitutional or that the allocation factor operates unfairly.

I

In 1981 Bendix[1] was a corporation organized under the laws of the State of Delaware, and had its principal office and commercial domicile at Bendix Center, Southfield, Michigan. Bendix was incorporated in

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[1] Bendix became a wholly-owned subsidiary of Allied Corporation in 1983 and was merged into Allied as of April 1, 1985.

Delaware in 1929 as a manufacturer of aviation and automotive parts.[2]

Over the years, Bendix developed into a multinational corporation with activities, either directly or through subsidiaries or other operating units, in all 50 states and 22 foreign countries. Bendix's core businesses expanded along several basic lines, so that for the period 1970 to 1981 there were four major Bendix operating groups (the "Major Groups"): (a) automotive; (b) aerospace/electronics; (c) industrial/energy and (d) forest products. For operational purposes, the various Bendix subsidiaries or other operating units were included by Bendix in one of the Major Groups, based on the type of business activity engaged in by that subsidiary or operating unit. Each subsidiary or operating unit had its own management which, in turn, reported to the chief executive of the Major Group in which the subsidiary or operating unit was included. The chief executives of the Major Groups reported directly to the chairman and chief executive officer of Bendix.

In 1937, Bendix obtained a certificate of authority to transact business in New Jersey. At all times relevant to this action, it was qualified to transact business in New Jersey, and its New Jersey activities consisted primarily of the operation of several Bendix units in the Aerospace Group at Teterboro, New Jersey, including Aerospace Flight Systems, Guidance Systems and Test Systems, and

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[2] The case was submitted to the court for decision on stipulated facts, from which the court's recital of the facts is drawn.

the manufacture of electric power-generating systems at a plant in Eatontown, New Jersey.

The Bendix Aerospace Flight Systems Division at Teterboro developed and manufactured flight control systems, cockpit displays, flight and engine instrumentation, air data computers, engine control systems, air inlet control systems, pressure and position sensors and transducers, and weapon release and control systems. In addition, supporting maintenance and customer service were provided for all of the manufactured products.

The Bendix Guidance Systems Division at Teterboro developed and manufactured inertial guidance equipment, gyroscopic devices, stabilization and control systems for space programs, and specialized missile and drone equipment.

The Bendix Test Systems Division at Teterboro developed and manufactured complete support systems for analog, digital, microwave and other devices, including the evaluation of test requirements, design and fabrication of test hardware and software, validation of test hardware compatibility, system configuration management, and logistic support of test systems. These three divisions performed their own research, engineering, marketing, accounting and computer services necessary to support their basic manufacturing operations.

Other Bendix Aerospace Group activities in New Jersey included Bendix Computer-Aided Engineering at Teterboro, which supported the computer-aided engineering requirements of all Bendix aerospace businesses worldwide, and a small Bendix Avionics

Division service facility in Morristown, New Jersey, which serviced and supported general aviation customers in central New Jersey.

The Bendix Electric Power Division in Eatontown developed and manufactured complete electric power-generating and control systems, including brushless AC and DC generators, solid-state control and static power conversion equipment, power-control and load-sensing components, electric starting systems, electric system test and checkout systems, and other related electric power system components. This division also performed the research, engineering, marketing, accounting and computer services necessary to support its basic manufacturing operations.

In addition to the activities of Bendix's Aerospace and Electric Power Divisions, Bendix Field Engineering Corporation, a wholly-owned subsidiary of Bendix, conducted two operations in New Jersey: (1) its Marine Science Services Division at Teterboro provided information to the worldwide ocean-going shipping industry, including ocean current and weather information, and (2) pursuant to a contract with the Federal Environmental Protection Agency ("EPA"), facilities management and maintenance support services were provided at an EPA facility in Edison, New Jersey.

Bendix also sold, both on a wholesale and retail basis, its full range of products to New Jersey customers, and stored inventory in New Jersey at locations owned by others.

II

Since 1965, Bendix had been pursuing an aggressive policy of growth through acquisition, acquiring approximately 35 companies by 1980. This was part of Bendix's program of selective acquisitions and divestitures of companies or assets which would enhance Bendix's existing product areas.

By internal memorandum dated March 31, 1978 to the members of the long-range planning committee, William M. Agee, Bendix's Chairman, stated:

> We believe ourselves to be strong enough financially and managerially to warrant several moves aimed at growth and diversification for the 80's.
>
> –Growth and diversification in the Industrial/
> Energy area.
>
> –Growth and rebalancing in the forest products area.
>
> –Investment in other basic resources that are now depressed and undervalued but that offer strong profit possibilities for the 80's.
>
> –Restructuring of Bendix Home Systems with a view to possible withdrawal in the next few years.

This March 31, 1978 memorandum goes on to state: "We have had an acquisition of a mining company in mind for some time because we are bullish on basic resources for the balance of the century." The

memorandum includes a thorough analysis of the copper industry and the qualities that would be desirable for an acquisition candidate, as well as a detailed discussion of a possible acquisition of Asarco.

Asarco

Asarco is engaged in copper mining and production in the United States and abroad, principally in Latin America. It is also a significant producer of lead, zinc, silver, asbestos, coal and other lesser metals. Asarco also has important equity holdings in Australia, Mexico, Nicaragua, Canada and elsewhere which make significant contributions to earnings.

As stated in an internal memorandum dated April 12, 1978 from Mr. Agee to the Board of Directors, acquisition of Asarco would help Bendix achieve the purposes of its acquisition strategies, which are:

> Reducing our dependence on relatively slow-growing aerospace and automotive OEM market.
>
> Broadening our Industrial/Energy Group to give it size and better definition.
>
> Generating good cash flow in the early 1980's to meet growing capital needs, particularly in aerospace/ electronics to permit it to hold its own in stiffening markets.
>
> Broadening our holding in basic commodities, particularly forest products and in non-fuel minerals that should prosper from the energy problem or which

have other reasons for a strong market position in the 1980's.

Through a series of purchases between December 1977 and November 1978 from Asarco and others, Bendix acquired 20.6% of Asarco's stock.

Two seats on the Asarco 14-member Board of Directors were filled by Mr. Agee and an outside director of Bendix. Because Bendix owned at least 20% of Asarco's stock, it was able to use the equity method of accounting whereby Bendix included its equity share, 20.6%, of Asarco's total earnings in its income.

During the years that Bendix held its investment in Asarco, the trading price of Asarco's stock increased, as did its dividend payments. In Bendix's fiscal 1979, Asarco contributed $ .82 per share to Bendix's total per share earnings of $7.10. In fiscal 1980, Asarco contributed $2.22 a share to Bendix's total per share earnings of $7.68.

In the fall of 1980, Bendix publicly announced that it was considering selling its Asarco stock. Among the reasons given for selling Bendix's interest were: (1) Bendix had decided to reduce its investment in businesses tied to natural resources, and (2) Bendix's investment in Asarco had appreciated considerably.

On October 29, 1980, Bendix and Asarco entered into an agreement under which Asarco agreed to purchase the shares owned by Bendix, at $55 per share. During fiscal 1981, pursuant to an agreement with Asarco to repurchase the shares, Bendix sold its Asarco stock to Asarco at $55 per share for a total sale price of approximately $335,879,500, of which approximately $211,500,000 was the long-term capital gain at issue.

United Geophysical Corporation

United Geophysical Corporation ("UGC") was in the business of seismic surveying, which involves the creation of underground acoustical waves through blasting or mechanical means and the recordation and interpretation of the wave patterns for purposes of locating oil and gas. UGC transacted no business in New Jersey. In 1965, Bendix purchased 100% of the stock of UGC.

The purchase of UGC was part of the effort by Bendix to diversify. Bendix's 1965 Annual Report to its shareholders states:

> We have accelerated our acquisitions program. Here our objective is not merely diversification. We intend to achieve a better balance of our military and commercial-industrial product sales. We intend to enhance and improve our competence in the fields where Bendix's leadership and talents are acknowledged by acquiring strong units that are supplementary. In May we acquired United Geophysical Corporation. This well-established organization is active world-wide in providing geophysical services to oil companies. Complementing our substantial oceanics endeavors, this acquisition will enable us to participate more fully in geophysical operations for petroleum and other minerals on a global basis.

From 1965 to 1968, UGC was included in Bendix's oceanics group. In 1968, the oceanics group was disbanded. Thereafter, UGC was included in Bendix's

industrial/energy group, and in later years the Bendix aerospace group had some oversight over UGC.

During the time that Bendix owned UGC (1965 to 1981), numerous Bendix employees served on UGC's Board of Directors or as UGC corporate officers. Certain senior management of UGC was supplied by Bendix. Murray Weingarten was vice-president of operations at Bendix Field Engineering Corporation ("BFEC") prior to becoming president of UGC in 1967. Bendix transferred Mr. Weingarten to UGC because it believed his experience managing BFEC, which like UGC was a service business, might be helpful in operating UGC and addressing certain of UGC's problems. Under Mr. Weingarten, UGC was reorganized. There was a significant reduction in staff, and new personnel policies were initiated.

Bendix approved UGC's annual financial plan, and Bendix's Board of Directors approved UGC's requests for capital expenditures above a certain dollar limit.

Bendix financed, at approximately $1,000,000 each, the construction of two ships for UGC to be used in marine seismic exploration. The Bendix logo appeared on the ships and other UGC equipment.

Bendix charged UGC, through the intercompany accounts, for services it provided. Among the services Bendix provided were auditing, legal advice, routine legal services, tax advice, tax return preparation, insurance advice, insurance coverage and computer access.

By memorandum dated November 13, 1980 to the Board of Directors, Mr. Agee set forth the reasons for the divestiture of UGC:

> [UGC] does not particularly relate to our other businesses regarding technology, marketing or management. Although UGC has been successful, geophysical seismic data acquisitions is a cyclical business. Historical experience indicates that exploration declines during peak periods of development of new oil and gas discoveries. UGC experienced its best year in 1980 due to the exploration boom caused by energy concerns. This climate has created a high degree of interest in oil and gas exploration, offering an excellent opportunity to divest UGC at a very favorable price.

In July 1981, Bendix sold 100% of the stock of UGC for approximately $80 million, resulting in a long-term capital gain of approximately $41.9 million.

Interest on the Proceeds from the Sale of Asarco and UGC Stock

In 1981 Bendix placed the proceeds from the sale of its 20.6% interest in Asarco and 100% of UGC in an interest-bearing investment account (the "account") with Lehman Brothers, Kuhn, Loeb ("Lehman Brothers"). The account was administered, and all securities on deposit were located, outside of New Jersey. The investments in the account were of a highly-liquid nature, generally with maturities of less than 90 days. During fiscal 1981, the Asarco and UGC proceeds in the account earned approximately $3.4 million in interest.

In late January 1981, Bendix made a public offer to purchase up to four million shares of Bendix stock. As reflected in Bendix's filings with the Securities and Exchange Commission in connection with this offer, the source of funds for the purchase of shares was the proceeds of Bendix's sale of its interests in Asarco and UGC. Furthermore, the cash proceeds from these sales which took place in fiscal 1981 created the liquidity and additional debt capacity needed to enable Bendix to be in a position to make a sizable acquisition if an appropriate acquisition candidate materialized. On August 24, 1982, Mr. Agee requested authorization from the Bendix Board to make a public offer to purchase up to 50% of the shares of Martin Marietta, with the intent to acquire the remaining 50% in exchange for Bendix shares. Martin Marietta's principal business was aerospace related. Bendix had an aerospace group and believed that its business and that of Martin Marietta were complementary.

III

This case poses the question of whether the State of New Jersey can include in the income base of Bendix, capital gain income realized by Bendix on the sale of its 20% interest in Asarco and its 100% interest in UGC and the interest income earned from the investment of that capital gain income. It is helpful at the outset to set forth the observations of the majority of the United States Supreme Court in its most recent decision on the subject. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 103 S. Ct. 2933 (1983).

> Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-

based tax, "tax value earned outside its borders." In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice. For this reason and others, we have long held that the Constitution imposes no single formula on the States, and that the taxpayer has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed. . ."

One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise. The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. [citations omitted]. 463 U.S. at 164-165.

The Court set forth the requirements for use of the unitary business/formula apportionment method as: (1) a minimal connection or nexus between interstate activities and the taxing state, and (2) the out-of-state activities of the purported unitary business must be related in some concrete way to the instate activities. With respect to the latter, the Court said:

> The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation. Container, supra, 103 S.Ct. at 2940.

There is no single test to determine whether a business is unitary. As the United States Supreme Court has said, and the New Jersey Supreme Court has echoed, "the unitary business concept is not, so to speak, unitary. "*Container, supra,* 463 U.S. at 167, 103 S.Ct. at 2941 (quoted in *Silent Hoist, supra,* 100 N.J. at 18). In fact, in *Container,* the United States Supreme Court refused to say whether any one factor would be sufficient, as a constitutional matter, to prove the existence of a unitary business. Rather, the Court looked at many individual factors taken in combination. *Container, supra,* 463 U.S. at 179-180, 103 S.Ct. 2948. A unitary case is thus intensely factual.

Let me first state as firmly as possible that in the subject case we are dealing with the *income of Bendix,* not

the income of Asarco or UGC. The line of cases from *Mobil* through *Container*[3] dealt primarily with taxation of income earned by the subsidiary and paid to the parent as dividends. Bendix is a different kind of unitary case. In this case, we are not dealing with subsidiary income paid to the parent as dividends, but with income earned by the parent on the sale of its assets. Therefore, unlike the cases from *Mobil* through *Container*, but like the case of *Silent Hoist*, in this case I must look to the activities of the parent, not those of the subsidiary, to determine whether the income is unitary.

For the purpose of this case, interest and capital gain income of the parent have different consequences for unitary purposes than dividend income from a subsidiary.[4] Although *Asarco Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982), makes reference to capital gain income of the parent, that case dealt primarily with dividend income from the subsidiary, holding that five subsidiaries were discrete

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[3] *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *Asarco Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth Co. v. Taxation and Revenue Dept. of the State of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933 (1983).

[4] Under the New Jersey Corporation Business Tax Act, capital gain income of a parent is subject to tax. N.J.S.A. 54:10A-4(k). Dividends of a subsidiary that is 80%–100% owned are not taxed to the parent, and only 50% of dividends from a subsidiary less than 80% owned are taxed to the parent. N.J.S.A. 54:10A-4(k)(5).

entities and the dividend income was not to be included as business income. Although the parties agreed and the Court agreed with the parties that interest and capital gain income derived from the five subsidiaries should be treated in the same manner as dividend income, the issue of whether interest income and capital gain income is the same or different from dividend income was not in dispute. Thus, the Court's acceptance of this treatment is not precedential. *See, W. Milford Tp. v. Garfield Recreation Comm.*, 194 N.J. Super. 148, 158, n.11, *citing Illinois State Bd. of Elections v. Socialist Workers Party*, 440 U.S. 173, 183, 99 S.Ct. 983, 989 (1979). Notwithstanding the treatment in *Asarco, Inc. v. Idaho*, interest and capital gain income of a parent is different from dividend income received from a subsidiary. Dividend income is that portion of the earnings of a subsidiary corporation that it chooses to distribute to its shareholders. Interest and capital gain income is income earned directly by the parent from the sale or use of the assets of the parent. Thus, conceptually, when determining the unitary issue, the court is justified in looking only at the parent when dealing with capital gain income, while in dealing with dividend income from a subsidiary the court is justified in looking at the subsidiary and its relation to its parent.

In its analysis of the line of case from *Mobil* to *Container*, the New Jersey Supreme Court, in *Silent Hoist & Crane Co. v. Taxation Div. Director*, 100 N.J. 1, 17 (1985), found that *Asarco Inc. v. Idaho* was modified by *Container*. The New Jersey Supreme Court commented that, in *Container*, "the Court appeared resolved to take itself out of the business of being a tax commission and made it clear that the taxpayer has the 'distinct burden of showing by "clear and cogent evidence" that the [state tax] results in extraterritorial values being taxed.'" *Silent Hoist, supra*, at 9-10. The New Jersey Supreme Court

stated that the only restraints the United States Supreme Court will impose are to inquire whether the state court applied the correct standard to the case and whether the judgment was within the realm of a permissible judgment.

Although *Silent Hoist* was a single corporation and Bendix operated through subsidiaries and divisions, the principles of *Silent Hoist* are applicable to the activities of Bendix, a parent corporation. Both cases deal with investment activity by a corporation with strong centralized management and a corporate strategy that combined operating and investment activity to achieve corporate goals. As stated by the New Jersey Supreme Court, "the focus must be on Silent Hoist's investment activity and other aspects of its corporate business and the role the investment activity plays in those other activities." *Silent Hoist, supra,* at 19. It is the corporate activity, not the corporate structure, that should govern the determination of this issue.

The subject of investment activity has been dealt with in *Silent Hoist, supra*:

> As we have seen, *Silent Hoist*'s investment capital was capable of being pledged, liquidated or converted to other uses of the company sales or real estate operations. To describe this economic power as passive does not reflect economic reality.
>
> The taxpayer would have us divide this investment income from the organic whole of the business enterprise. This is, however, not a matter of constitutional law, but a matter of tax preference. Our job is not to rewrite the State's Corporation Business

> Tax but to apply it as intended. New Jersey's tax policy is quite distinct from the majority of states. We do not seek to allocate non-business income to the place of commercial or legal domicile. On the other hand, we accommodate our tax policy to the modern business complex by specifically excluding all dividends from subsidiaries (at least 80% owned) and 50% of other dividend income.
>
> We are more than satisfied here that there was a distinct sharing of the value of common management, accounting and operations that takes the portfolio income of this taxpayer well within the concept of a unitary business. [footnote omitted] At 22-23.

The Director concedes that the activities of Asarco are unrelated to those of Bendix. If the court were to look solely to the activities of Asarco, it could conclude that Asarco is itself a discrete entity. However, here, we are dealing with capital gain income from the sale of Bendix's minority interest in Asarco, and therefore look to the activities of Bendix, not those of Asarco. The activities in issue are investment activities, and the unitary business question is resolved, as in *Silent Hoist*, by examining taxpayer's activities in managing the investment, not the nature of the activities of the subject of the investment.

Viewing the issue in terms of Bendix's investment activity against the background of the decision of the New Jersey Supreme Court in *Silent Hoist* leads this court to the conclusion that the investment was an active one, and that the capital gain income from the investment is unitary and must be included in the income base when

applying the formula for apportioning the income of Bendix within and without the state. The Bendix investment in Asarco was more than passive by virtue of Bendix's control over the investment and because it was a significant part of the Bendix corporate strategy.

The purchase of a minority share in Asarco was part of a Bendix plan for growth and diversification in the 1980's which called for investing in depressed and undervalued basic resources to achieve the planned result of a stronger, diversified company. This investment was made only after a thorough analysis of the copper industry and the qualities of specific acquisition candidates. The Asarco investment was part of a well-orchestrated corporate strategy designed to enhance Bendix's current status, as well as position Bendix for the future. To describe this investment as passive would ignore the New Jersey Supreme Court's decision in *Silent Hoist* and disregard economic reality. The determination of the New Jersey Supreme Court in *Silent Hoist* has set the course for this court to follow.

Bendix relies on the decision of the Supreme Court of Missouri in the case of *James v. International Telephone & Telegraph Corp.*, 654 S.W.2d 835 (Mo. Banc. 1983). In that case, the court held that long-term capital gain income realized from the sale of four subsidiaries was not "business income" for the purpose of income allocation under the Missouri corporation income tax. Missouri is one of approximately 24 states which have adopted the Uniform Division of Income for Tax Purposes Act

("UDITPA").[5] States which have adopted UDITPA only apportion business income, which is income related to the taxpayer's regular course of business. Nonbusiness income, which would include rent and royalties from real or tangible personal property, capital gains, interest, dividends or patent and copyright royalties to the extent they are unrelated to taxpayer's regular course of business, is taxable only in the state of taxpayer's commercial domicile. It would appear that in a UDITPA state most investment income would be nonbusiness income and therefore not apportionable in the non-domiciliary state. The *James* court held that long-term capital gain income realized from the sale of four subsidiaries was not "business income" for the purpose of income allocation under the Missouri corporation income tax. Because Missouri is a UDITPA state, it appears that the court would have had to make a finding that the taxpayer was in the business of buying and selling subsidiaries in order to find that the capital gain income from the sale of the subsidiaries was business

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[5] New Jersey has not adopted UDITPA. All unitary income must be reported and is then apportioned to New Jersey under the three-factor formula. There are no statutory provisions permitting specific allocation ("tracing particular property, receipts, or income to their source or other connection with a state and attributing the item in toto to that state," Hellerstein, *State Taxation, I Corporate Income and Franchise Taxes* (1983), P8.4 at 328) or separate accounting ("a technique of carving out of the overall business of the taxpayer the activities taking place, the property employed in, and the income derived from, sources within a single state, and by accounting analysis ascertaining the profits attributable to that portion of the business." *Id.*, P8.3 at 323).

income. The court concluded that the record did not support that contention of the State of Missouri. Therefore, the Missouri court never reached the question of whether capital gains earned on the sale of a subsidiary is apportionable unitary income where there is a showing of actual planned and controlled corporate investment activity, such as has been shown in the subject case.[6]

Furthermore, there is no claim by taxpayer of double taxation, and there is no evidence that Michigan, the state of Bendix's commercial domicile, has treated the subject income as nonbusiness income.

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[6] I also note that the decision in *Asarco, Inc. v. Idaho, supra,* on the unitary issue was influenced by the business/non-business income distinction because Idaho is a UDITPA state. *See Silent Hoist, supra,* at 22-23, n. 8. There is a significant difference between the *James* case and this case. In *James,* the court had to determine whether the capital gain income was business or nonbusiness income, and made its determination based on the activities of the subsidiaries, not those of the parent. The issue in the present case is not whether the income is business income or nonbusiness income but, as required by the decision of the New Jersey Supreme Court in *Silent Hoist,* whether the investment activity is active or passive. Following *Silent Hoist,* this must be determined by considering the activities of Bendix with respect to the investment, not the activities of the subsidiaries in which it invested. I conclude that the holding in *James v. ITT* is irrelevant to the facts of the present case and that *Silent Hoist* is not only relevant, but is controlling on this court. Therefore, the inclusion of the subject capital gains and interest income does not violate the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

IV

In accordance with the foregoing reasoning, the capital gain realized by Bendix on the purchase and sale of UGC is also regarded as unitary income from an active investment, as is the income from the proceeds of the Asarco and UGC sales deposited temporarily by Bendix with Lehman Brothers to be held and invested until needed in pursuance of Bendix's corporate strategy. The funds were actually used shortly after their receipt, to further the corporate purposes of Bendix, consistent with its corporate strategy, in the acquisition by Bendix of its stock and the subsequent use of that stock and the funds in connection with its attempted acquisition of Martin Marietta Co.

It should also be noted that there was substantially more interaction between Bendix and UGC, its 100% owned subsidiary, than between Bendix and Asarco. However, in considering the capital gain income of Bendix, the court looks to the investment activity of Bendix, not the activity of the subsidiary or its relationship to its parent.

V

Taxpayer argues that if Asarco and UGC are regarded as part of Bendix's unitary business, the allocation formula as applied by the Director should be modified to include the property, sales and payroll of these two companies—Asarco to the extent of 20% and UGC 100%.

The burden is on Bendix to establish that the tax liability is "out of all appropriate proportion to the business transacted" in the taxing state itself. *Silent Hoist,*

supra, at 10, quoting *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135, 51 S.Ct. 385, 389 (1931). The court finds that there is no reason to alter the statutory allocation formula in this case because the income is capital gain income of Bendix, not income of Asarco or UGC, and there is no proof that the result of the statutory allocation formula, which allocates 7.980727% of Bendix's income to New Jersey, taxes extraterritorial value, or is distorted or unfair.

The Clerk of the Tax Court is directed to enter judgment affirming the fiscal 1981 deficiency tax assessment of the Director.

APPENDIX D

NEW JERSEY STATUTES INVOLVED

54:10A-1. Short title

This act shall be known as the Corporation Business Tax Act (1945).

54:10A-2. Franchise tax; annual payment in lieu of taxes upon intangible personal property; "doing business, employing or owning capital or property in state" defined

Every domestic or foreign corporation which is not hereinafter exempted shall pay an annual franchise tax for the year 1946 and each year thereafter, as hereinafter provided, for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State. And such franchise tax shall be in lieu of all other State, county or local taxation upon or measured by intangible personal property used in business by corporations liable to taxation under this act but, whenever such corporation holds shares of stock in a bank as defined in R.S. 54:9-1, and such bank has not elected to have the taxable value of such shares assessed to it and to pay the tax levied against such shares as provided in R.S. 54:9-14, or, having made such election, such bank subsequently revokes it, the provisions of this section shall not exempt such shares of stock from the tax imposed by chapter 9 of Title 54 of the Revised Statutes.

A foreign corporation shall not be deemed to be doing business, employing or owning capital or property in the State, for the purposes of this act, by reason of (1) the maintenance of cash balances with banks or trust companies in this State, or (2) the ownership of shares of stock or securities in this State if such shares or securities are pledged as collateral security, or deposited with one or more banks or trust companies or brokers who are members of a recognized security exchange, in safekeeping or custody accounts, or (3) the taking of any action by any such bank or trust company or broker, which is incidental to the rendering of safekeeping or custodian service to such corporation.

54:10A-4. Definitions

For the purposes of this act, unless the context requires a different meaning:

* * *

(k) "Entire net income" shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its Federal income tax; provided, however, that in the determination of such entire net income,

(1) Entire net income shall not include 50% of dividends which were included in computing such taxable income for Federal income tax purposes;

(2) Entire net income shall be determined without the exclusion, deduction or credit of:

(A) the amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporation;

(B) any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in subsection (k)(1) of this section;

(C) taxes paid or accrued to the United States on or measured by profits or income, or the tax imposed by this act;

(D) net operating losses sustained during any year or period other than that covered by the report;

(E) 90% of interest on indebtedness owing directly or indirectly to holders of 10% or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes; except that such interest may, in any event, be deducted

(i) up to an amount not exceeding $1,000.00,

(ii) in full to the extent that it relates to bonds or other evidences of indebtedness issued, with stock, pursuant to a bona fide plan of reorganization, to persons, who, prior to such reorganization, were bona fide creditors of the corporation or its predecessors, but were not stockholders or shareholders thereof;

(3) The commissioner may, whenever necessary to properly reflect the entire net income of any taxpayer, determine the year or period in which any item of income or deduction shall be included, without being limited to the method of accounting employed by the taxpayer.

APPENDIX E

RULE 29.1
LISTING OF NON-WHOLLY-OWNED AFFILIATES OF ALLIED-SIGNAL INC.

ACE Insurance Company (Bermuda), Ltd.
ACE Insurance Company, Ltd.
ACE, Limited
AIFCO Filters (Egypt)
ASA Investerings (Partnership)
Allied-Apical Company (Partnership)
Allied-General Nuclear Services (Partnership)
Amoricaine de Fonderie Le Chatelet, S.A.
Asia Pacific Resin Corporation
Bendix Atlantic Inflator Company (Partnership)
Bendix Electronic Service Corporation de España, S.A.
Bendix España, S.A.
Bendix Europe Services Technique S.A.
Bendix Europe, S.A.
Bendix Group Superannuation Pty., Ltd.
Bendix Mexicana, S.A. de C.V.
Bendix Mintex Proprietary Limited
Bendix Otomotiv Sanayi Ve Ticaret, A.S.
Bendix-Jidosha Kiki Corporation
Bunker Ramo Electronic Data Systems S.A.
CFE Company (Partnership)
Cataleasco, Inc.
Central Nice, Ltd.
Chico Corporation
Coalition Remedial Efforts, Inc.
Compania Industrial de Fluorita, S.A.

Compania Metalurgica de Parral, S.A.
Coopers Filters, Ltd.
D.B.A. S.I.B.E., SNC (Partnership)
Delaney Gallay Dynamics, Ltd.
Don Brake Lenings Pty.
Don Eastern Sdn Bhd
Doosan Electro-Materials Co., Ltd.
Dynamic Turbocharger Services Pty., Ltd. Queensland
Dynamic Turbocharger Services Pty., Ltd. Victoria
Ferranti plc
Ferranti-Bendix Power Generation Limited
FIAAM Filter S.p.A.
Fram Espana S.A.
Fram Europe A.B.
Fram Europe B.V.
Fram Europe Limited
Fram Europe (Marketing) A.B.
Fram Filter, S.p.A.
France Automobile Service, S.A.
Garrett Comtronics Licensing Corp.
Garrett Turbo India, Ltd.
Globe Auto Electricals, Ltd.
Greyco, S.A.
HBH Company (Partnership)
Hankuk Brake Industrial Co., Ltd.
Industrial Turbines International Inc.
International Robomation Intelligence Inc.
International Technigroup Inc.
International Turbine Engine Corporation
Japan Gasoline Co., Inc.
Jidosha Kiki Co., Ltd.
JSR Allied Corporation
Kalyani Brakes Limited
Kanto Seiatsu Kogyo Co., Ltd.
Katalistiks International Inc.
La Industrial Plastica y Metalurgica, S.A.

Leaseway All-Services, Inc.
Light Helicopter Turbine Engine Company (Partnership)
Lucas Air-Equipment S.A.
Lucky Allied Plastics Corporation
Manbritt Industries, Inc.
Morristown Airport Customs Association (Partnership)
Morton Bendix Company (Partnership)
NGL (Singapore) Pte., Ltd.
Niigata Technos Co., Ltd.
Nikki-Universal Co., Ltd.
Nippon Amorphous Metals Co., Ltd.
Nirlon Synthetic Fibres and Chemicals, Ltd.
Nitto Boseki Company Ltd.
Nittobo-Norplex/Oak Co., Ltd.
Normalair Garrett (Holdings) Ltd.
Normalair Garrett Manufacturing Pty., Ltd.
Normalair Garrett Pty., Ltd.
Normalair Gerrett, Ltd.
Norplex Oak India Limited
Oak-Mitsui (Partnership)
Oak-Mitsui Inc.
Paxon Polymer Company (Limited Partnership)
Prestolite of India Ltd.
Propelentes Mexicanos, S.A.
Quimobasicos, S.A.
Rovert (1987), Ltd.
SAPDCO Bendix (Saudi Arabia) Limited
Seo Han-Bendix Company Limited
Shanghai UOP-UCC Molecular Sieve Co., Ltd.
Sifra Industrie, S.A.
Société d'Etudes et de Constructions Aero-Navales [SECAN]
Stop Iberica, S.A.
Synektron Corporation
TAC (Aircraft Controls), Ltd.
Technos Co., Ltd.

TENSA, S.A.
Transpar Iberica, S.A.
Turbodina S.A.I.Y.C.
UMP Limited
Union Showa K.K.
Union Texas Exploration Corporation
Union Texas International Corporation
Union Texas Petroleum Holdings, Inc.
Universal Oil Products Company
UOP (Partnership)
UOP B.V.
UOP Canada Inc.
UOP Charitable Foundation, Inc.
UOP Dubai Limited
UOP Equetec Services, Inc.
UOP France, S.A.
UOP GmbH
UOP Iberia, S.A.
UOP Inc.
UOP International Services Limited
UOP International Technology Limited
UOP K.K.
UOP Limited
UOP Management Services, Inc.
UOP Management Services (Saudi Arabia) Limited
UOP M.S. S.p.A.
UOP N.V.
UOP Pacific Ltd.
UOP Process International, Inc.
UOP Processos Industrials do Brasil Ltda.
UOP S.p.A.
USHA Amorphous Metals Ltd.

Supreme Court, U.S.
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(2)

No. 91-615

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL, INC.
as successor-in-interest to
The Bendix Corporation,

Petitioner

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of New Jersey

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the unitary business principle permits a nondomiciliary state to tax a multistate corporation on income derived from a minority stock investment when the investment is integral to the corporation's operational strategies of enhancing the corporation's existing businesses and diversifying into other businesses through the acquisition and divestiture of other corporations.

TABLE OF CONTENTS

Page

COUNTERSTATEMENT OF THE CASE 1

SUMMARY OF ARGUMENT..... 12

ARGUMENT

I. THE PETITION FOR CERTIORARI SHOULD BE DENIED BECAUSE THE DECISION OF THE SUPREME COURT OF NEW JERSEY DOES NOT CONFLICT WITH OTHER STATE COURT DECISIONS..... 13

II. THE PETITION FOR CERTIORARI SHOULD BE DENIED BECAUSE THE DECISION OF THE SUPREME COURT OF NEW JERSEY IS CONSISTENT WITH THIS COURT'S DECISIONS 18

CONCLUSION 22

APPENDIX

Excerpts from Stipulation of Facts filed in the Tax Court of New Jersey 1a

TABLE OF AUTHORITIES

Page

CASES

Amerada Hess Corp. v. Director, Div. of Taxation, 490 *U.S.* 66 (1989) 21

American Home Products Corp. v. Director, Div. of Taxation, 11 *N.J. Tax* 287 (Tax Ct. 1990), app. pndg. N.J. Super. Ct. App. Div. No. A-4316-90T3 15

ASARCO, Inc. v. Idaho State Tax Comm'n, 458 *U.S.* 307 (1982) 12, 13, 14, 18, 19

Brunner Enterprises, Inc. v. Dep't of Revenue, 452 *So.* 2d 550 (Fla. 1984) 16

Container Corp. of America v. Franchise Tax Bd., 463 *U.S.* 159 (1983) ..... *passim*

Corning Glass Works, Inc. v. Virginia Dep't of Taxation, 241 *Va.* 353, 402 *S.E.* 2d 35 (1991), *cert.* den. 60 *U.S.L.W.* 3265 (Oct. 7, 1991) (No. 90-1852). 15

Dep't of Revenue v. Brunner Enterprises, Inc., 390 *So.*2d 713 (Fla. 1980). 16

F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 *U.S.* 354 (1982) 12, 13, 18, 19

International Paper Co. v. Taxation Div. Director, 11 *N.J. Tax* 147 (Tax Ct. 1990, en banc), aff'd ___ *N.J. Tax* ___ (App. Div. 1991), certif. den. ___ N.J. ___, ___ *A.*2d ___ (No. 33,784, Oct. 16, 1991) 14

James v. Int'l Tel. & Tel. Corp., 654 *S.W.*2d 865 (Mo. 1983) 15, 16

Mobil Oil Corp. v. Comm'r of Taxes, 445 *U.S.* 425 (1980) 17

TABLE OF AUTHORITIES – Continued

Page

Mobil Oil Corp. v. Director, Div. of Taxation, 11 *N.J.Tax* 344 (Tax Ct. 1990), app. pndg. N.J. Super. Ct. App. Div. No. A-2326-90T5 14

NCR Corp. v. Comptroller, 313 *Md.* 118, 544 *A.*2d 764 (1988) 17

Pledger v. Illinois Tool Works, Inc., 306 *Ark.* 134, 812 *S.W.*2d 101 (1991), *cert.* den. 60 *U.S.L.W.* ___ (Nov. 12, 1991) (No. 91-530) 16

Silent Hoist & Crane Co., Inc. v. Director, Div. of Taxation, 100 *N.J.* 1, 494 *A.*2d 775, *cert.* den. 474 *U.S.* 995 (1985) 10, 16

STATUTES AND REGULATIONS

New Jersey Corporation Business Tax Act, *N.J. Stat. Ann.* § 54:10A-4(k) (West 1986) 16

New Jersey Admin. Code tit. 18, § 7-11.15 (1991)..... 16

COUNTERSTATEMENT OF THE CASE

A. Bendix' Acquisitions and Divestitures

Petitioner's predecessor-in-interest The Bendix Corporation ("Bendix") was incorporated in 1929 as a manufacturer of aviation and automotive parts (Stip. ¶7)* and in 1937 received a certificate of authority to do business in New Jersey (Stip. ¶8).

At least as early as 1965, Bendix began a program of growth and diversification through the acquisition and occasional divestiture of other corporations. In 1965, Bendix bought the stock of United Geophysical Corporation ("UGC") (Stip. ¶69). According to its Annual Report to Shareholders for that year, Bendix was in the process of accelerating its acquisitions program with the intent not merely of diversifying but also of achieving a better balance between its military and nonmilitary sales. The UGC investment was thought to be complementary to Bendix' oceanics endeavors (Stip. ¶70). UGC's business was seismic surveying (Stip. ¶71), a business in which Bendix had not previously engaged (Stip. ¶73).

In 1966 Bendix made seven acquisitions, including three corporations in the machine tool industry, one in the automotive industry, one which made medical electronics equipment for doctors, a corporation involved in applied oceanography, and a fiber optics producer (Stip.

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* The designation "Stip. ¶___" refers to the parties' stipulation of facts filed in the Tax Court of New Jersey, relevant portions of which are included (without exhibits) in the appendix to this brief.

¶132). In 1967 Bendix acquired five companies and disposed of its marine division (Stip. ¶¶133, 134). These acquisitions involved the automotive industry, machine tool industry, and Texas Pipe Bending Company, which manufactured welded pipe (Stip. ¶133). In 1968 Bendix or its subsidiary Fram Corporation (acquired the previous year) made five acquisitions in various industries ranging from automotive parts to rubber products to vacuum systems (Stip. ¶135). During 1969 Bendix or its subsidiary Fram Corporation made six acquisitions including two machine tool companies, a company making glass for the automotive industry, the remaining stock of Aviation Electric, Ltd., the remaining stock of Bendix-Westinghouse Automotive Air Brake Company, and Skagit Corporation, which manufactured logging and handling equipment (Stip. ¶137). In the same year Bendix disposed of three businesses (Stip. ¶138).

Summarizing Bendix' strategies to date, its then chairman of the board stated in the 1969 Annual Report to Shareholders that diversification in order to make Bendix less dependent on the government sector had been one of Bendix' goals and that the company's growth during the past 10 years had been achieved in significant part through acquisitions (Stip. ¶136).

In 1970 Bendix acquired and then merged with the American Forest Products Corporation. AFPC (which became Bendix Forest Products Corporation) was in the timber management, lumber, building materials, wood and corrugated containers, and aluminum siding businesses (Stip. ¶139). Like the prior acquisitions of UGC and Skagit Corporation, the acquisition of AFPC represented a new departure and a new business for Bendix

(Stip. ¶130). AFPC was Bendix' largest acquisition to date (Stip. ¶139) and established an entire major operating group for the company (Stip. ¶¶11, 13). In 1971 Bendix made six small acquisitions and acquired a 50% interest in two European companies (Stip. ¶140).

The chairman's message in the 1972 Annual Report to Shareholders mentions the goal of expanding Bendix' role in countercyclical markets (Stip. ¶141). The principles of diversification and involvement in countercyclical markets were further described in Bendix' 1973 Annual Report to Shareholders (Stip. ¶143). The 1975, 1976 and 1977 Annual Reports reiterate the themes of diversification and less dependence on government contracts (Stip. ¶¶144, 146, 147).

In 1973 Bendix purchased Boise Cascade's international mobile home and recreational vehicle businesses, which became Bendix Home Systems, and purchased the Autolite spark plug manufacturing facility and the Autolite trademark from the Ford Motor Company (Stip. ¶142). In 1977 Bendix acquired Coin Millwork, a maker of wood moldings (Stip. ¶147). This acquisition was consistent with Bendix' strategy for its forest products group to integrate forward in the distribution chain (Stip. ¶¶29, 129).

In fact, there was a clearly articulated goal, which translated into an acquisitions strategy, for each of Bendix' major groups. By 1978, these major groups consisted of the automotive group, aerospace group, forest products group, and industrial-energy group (Stip. ¶¶11, 148). In aerospace Bendix was primarily a subcontractor of aviation components (Stip. ¶163). Its long-term goal for

that segment of its business was to move into the production of whole systems (Stip. ¶29).

In 1978 Bendix acquired a company for its automotive group, acquired two small companies in the aerospace-electronics area, and sold a portion of Bendix Home Systems (Stip. ¶149). Additionally, during that year, Bendix made its largest investment to date, the purchase of 20.6% of the shares of ASARCO, Inc. for approximately $127.6 million (Stip. ¶¶150, 52). As was true of its earlier acquisitions of UGC, Skagit, and American Forest Products Corporation, the ASARCO investment represented a diversification for Bendix; prior to that date, the company had no involvement in the nonferrous metals industry (Stip. ¶150).

During 1979 Bendix continued its strategy for the forest products group of moving forward in the distribution chain with the acquisition of Bass & Company, a producer and distributor of building materials, and the acquisition of the Caradco Division of Scoville, a producer of windows and sliding doors (Stip. ¶152). In that year's letter to shareholders, the then chairman summarized Bendix' strategy as one of "diversification aimed at insulating the Company's total profitability from the cyclical troubles of any particular industry or business," combined with an effort to seek out "high return, high growth segments" of Bendix' markets (Stip. ¶151). In 1980 Bendix purchased a machine tool manufacturer for $300.7 million (Stip. ¶153).

During 1980, Bendix' management determined to focus the corporation more heavily on the high technology aspects of its existing businesses, to acquire high

technology businesses, and to dispose of certain of its noncore businesses (Stip. ¶154). Implementing this shift in strategy, Bendix sold Skagit Corporation in 1980 (Stip. ¶153), took steps to sell its other noncore businesses (T69-24 to T70-7),* specifically those included in its natural resources group (Stip. ¶155), established an Advanced Technology Center (Stip. ¶154), set up a technical ventures group to evaluate and recommend certain relatively modest acquisitions of high technology businesses (Stip. ¶30), took stock positions (some of them sizeable) in high technology companies, specifically RCA, Gould, Lockheed and General Dynamics (T96-24 to T97-7), and established within the Bendix planning department a screening program to select a major acquisition candidate in a high technology business (Stip. ¶30). The screening program lasted for nearly two years and led to the selection of Martin Marietta Corporation as the acquisition candidate (Stip. ¶30).

Consistent with its shift in strategy away from natural resource businesses and into high technology, Bendix sold its natural resource companies in the 1981 fiscal year. Dispositions during this period included Bendix Forest Products Corporation for $435 million, UGC for $80 million, Bass, Caradco and Modern Materials for a total loss of $12.5 million, and Bendix' stock in ASARCO for $336 million (Stip. ¶156).

Summarizing Bendix' investments in the forest products business and ASARCO, William Agee, Bendix' chief

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* The designation "T" refers to the transcript of the deposition of W.M. Agee, chairman of Bendix from 1977 to 1983, which was stipulated into evidence.

executive officer, stated in the 1980 Annual Report to Shareholders that both investments were part of Bendix' strategy "of diversification as an insulator against the cyclicality of any particular business. . . . " (Stip. ¶158).

Bendix' immediate use of a portion of the cash proceeds generated by its 1980 and 1981 dispositions was the repurchase of some 4 million of its own shares (Stip. ¶160) for approximately $257.5 million (Stip. ¶127). In addition, the influx of cash created liquidity and additional debt capacity to enable Bendix to make a sizeable acquisition in the event an appropriate acquisition candidate materialized (Stip. ¶161).

In August 1982, Agee requested authorization from the Bendix Board to make a tender offer for up to 50% of the shares of Martin Marietta Corporation (Stip. ¶162). Bendix viewed the proposed acquisition of Martin Marietta as consistent with the company's long-term goal for the aerospace group of moving into the production of entire systems and subsystems rather than remaining a subcontractor of component parts (Stip. ¶¶29, 163). Agee's memorandum to the Bendix Board states that the combination of Bendix and Martin Marietta would convert Bendix to a company "predominantly engaged in aerospace/electronics activities" with less exposure to the automotive market. The acquisition was unsuccessful and led to Bendix becoming a subsidiary of Allied Corporation (Stip. ¶¶164, 165).

B. Purchase of ASARCO Stock

Bendix began planning for an acquisition in the natural resources area in the spring of 1977. In April of that

year Agee received a memorandum from the Bendix planning department presenting a survey of natural resource companies, primarily mineral companies (Stip. Exhibit D). The memorandum mentions three possible forms for the acquisition. The summary notes that natural resource companies tend to be countercyclical to the overall economy and would "offer Bendix an opportunity for diversifying. . . . " By the spring of 1978, Bendix had acquired on the open market 4.9% of the stock of ASARCO (Stip. Exhibit F).

At the end of March 1978, Agee presented to the long-range planning committee of the Bendix Board a memorandum, authored by the head of the company's planning department with input by Agee, on long-range growth and acquisition planning for the company (Stip. ¶44; Stip. Exhibit E; *see* App. A at 5a-6a; App. B at 37a-40a).* The memorandum begins by stating that company's financial and managerial strength "warrant several major moves aimed at growth and diversification for the 80's" and then lists four possible steps, three of them involving Bendix' existing businesses and the fourth involving "investment in other basic resources that are now depressed and undervalued but that offer strong profit possibilities for the 80's." Fruitful areas for acquisition included "greater involvement in basic resources. . . . " The memorandum then discusses the reasons for acquiring a mining company, which included their undervaluation and the threat of worldwide shortages in basic commodities. Determining that ASARCO closely matches the qualities that Bendix is seeking, the authors state

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* The designation "App. ___ at ___ a" refers to the appendix to the petition for *certiorari*.

that they favor acquiring 20% rather than a majority or 100% of ASARCO's shares. The smaller financial commitment will, they write, permit Bendix to complete its other acquisitions in forest products and industrial energy, and a 20% position will give Bendix "time to become more familiar with the company and the industry before chancing a significantly larger position." The memorandum continues that Bendix will seek representation on ASARCO's Board and with this representation will gain information about the company and the industry preparatory to deciding "whether to enlarge or sell our holdings" (Stip. Exhibit E).

The long-range planning committee approved the acquisition of a 20% interest in ASARCO, and on April 13, 1978, Agee requested approval from the Bendix Board to make the acquisition (Stip. ¶¶46, 47). In seeking Board approval, Agee presented a memorandum dated April 12, 1978 (Stip. Exhibit F, *see* App. B at 40a). The acquisition, according to Agee's memorandum, will aid the company's acquisition strategies, which include reducing Bendix' dependence on the slower growing areas of its business, namely aerospace and the automotive original entry market, generating good cash flow "to meet growing capital needs, particularly in aerospace/electronics . . . ," and broadening Bendix' holdings of basic commodities including forest products and non-fuel minerals.

The Bendix Board approved the proposed acquisition, and Bendix' investment subsequently reached 20.6% of ASARCO's stock. Bendix was able to obtain two seats on ASARCO's 14-member board of directors, which were

filled by Agee and a Bendix outside director (Stip. ¶¶51, 53).

At every board meeting while Bendix held its 20.6% stock interest, the Bendix Board was presented with a summary of ASARCO's earnings and the effect of those earnings on Bendix (Stip. ¶57; Stip. Exhibit I).

During the period that Bendix held 20.6% of the stock of ASARCO, the only contracts between the *operations* of plaintiff and the *operations* of ASARCO were the presence of Messrs. Agee and Baldridge (Stip. ¶53) on ASARCO's Board, a minute amount of sales by ASARCO subsidiaries to Bendix (Stip. ¶62), and quarterly visits by individuals in the Bendix controller's department to ASARCO's headquarters in New York in order to review ASARCO's books to enable Bendix to report the ASARCO investment on the equity method of accounting (Stip. ¶56).

C. Sale of ASARCO Stock

The decision to sell and the sale of Bendix' interest in ASARCO were part of a major restructuring of the company, which was intended to eliminate Bendix' noncore businesses and focus the company more intently in high technology areas (T85-3 to T86-14; Stip. ¶¶64, 154, 155). The noncore businesses that Bendix determined to sell included Texas Pipe Bending, UGC, Skagit, Bendix Forest Products Corporation, and ASARCO (T78-24 to T79-3).

The several divestitures generated cash proceeds of approximately $838.5 million (Stip. ¶156), which were placed in a money market account at Lehman Brothers, Kuhn, Loeb (Stip. ¶117). In the spring of 1981, Bendix

purchased approximately 4 million of its own shares for a total price of $257.5 million, a sum which was withdrawn from the Lehman Brothers account (Stip. ¶¶124, 126, 127). With minor exceptions, the Lehman Brothers account was invested in highly liquid, interest bearing obligations with maturities of less than 90 days (Stip. ¶123). The cash was thus readily available in the event Bendix determined to make an acquisition (T84-11 to 17).

D. The Decisions Below

Relying on *Container Corp. of America v. Franchise Tax Bd.*, 463 *U.S.* 159 (1983) and the New Jersey Supreme Court's decision in *Silent Hoist & Crane Co., Inc. v. Director, Div. of Taxation*, 100 *N.J.* 1, 494 *A.*2d 775, *cert.* den. 474 *U.S.* 995 (1985), the Tax Court of New Jersey concluded that the ASARCO investment was part of Bendix' unitary business. The investment was one element in a "well-orchestrated corporate strategy designed to enhance Bendix's current status as well as position Bendix for the future" (App. C at 63a). Consistent with the decisions in *Container* (*see* 463 *U.S.* at 180 n. 19) and *Silent Hoist*, the Tax Court focused on Bendix' management of the ASARCO investment in concluding that the investment was unitary with the rest of Bendix' operations (App. C at 62a).*

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* The New Jersey Tax Court rejected Bendix' argument that the capital gain derived from the sale of its stock in UGC was nonunitary, rejected Bendix' argument that interest earned on the Lehman Brothers account attributable to the proceeds of the Asarco and UCG stock sales was nonunitary, and rejected

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Taking greater note of the unique facts of the case, the Appellate Division of the New Jersey Superior Court affirmed the Tax Court. The Appellate Division pointed to Bendix' analysis of the ASARCO acquisition, described the numerous acquisitions and divestitures and the corporate strategy set out in Bendix' annual reports, and concluded that "Bendix's unitary business included implementation of this policy of acquiring interests in diverse industries to achieve the goals of growth, cyclical protection and corporate balance" (App. B at 44a). According to the Appellate Division, "The record establishes that Bendix acquired assets based on their fit within the framework of existing Bendix operations and their utility as stepping stones to additional acquisitions, and not merely for their capacity to generate income" (*Id.* at 35a).

Emphasizing somewhat different facts, the Supreme Court of New Jersey affirmed the Appellate Division. The Court focused to a greater extent on the role of the sale of the ASARCO stock in Bendix' subsequent attempt to acquire Martin Marietta (App. A at 10a). The Court noted as well the central role played by Bendix' chairman William Agee (*id.* at 4a, 5a, 10a-11a). According to the New Jersey Supreme Court, the facts and "underlying economic realities" must determine the resolution of each unitary business case, and consequently under this

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Bendix' claim that the statutory apportionment formula under the New Jersey Corporation Business Tax Act operated so unfairly as to deprive it of constitutional due process (App. C at 66a). Bendix does not raise these issues in its appeal to this Court.

Court's teachings there is no "per se or bright line standard for defining a unitary business" (*Id.* at 15a). Relying on *Container*, the New Jersey court found the necessary transfers of value in Bendix' "business function of corporate acquisitions and divestitures that was an integral operational activity" (*id.* at 19a) and noted the absence of any such operational strategy in *ASARCO, Inc. v. Idaho State Tax Commission*, 458 *U.S.* 307 (1982) and *F.W. Woolworth Co. v. Taxation and Revenue Dep't.*, 458 *U.S.* 354 (1982) (App. A at 21a).

SUMMARY OF ARGUMENT

This is a fact-bound case not appropriate for plenary review. The record demonstrates that Bendix' investment in 20% of the stock of ASARCO was one step in a long-standing operational strategy that took Bendix from its original business as a manufacturer of aviation and automotive parts to a corporation engaged in the automotive, aerospace, industrial, and natural resource businesses. The record reveals that Bendix purchased and sold the stock of ASARCO as part of its operational strategies. These strategies included the expansion of Bendix' existing businesses through corporate acquisitions designed to accomplish particular operational goals, goals that were specific to each of Bendix' major operating groups. These strategies also included diversification of Bendix' businesses through corporate acquisitions designed to shift Bendix' operations into areas of potential growth and greater profitability.

In light of the unique record, the decision of the New Jersey Supreme Court does not conflict with decisions of other state courts on the unitary business issue. For the same reason, the decision below does not conflict with this Court's unitary business decisions. The record is wholly unlike that before the Court in *ASARCO* and *Woolworth*. The decision below carefully applies the standards established in *Container* finding the requisite "sharing or exchange of value," 463 *U.S.* at 166, sufficient to establish that the ASARCO investment was part of Bendix' otherwise unitary business.

As there is no conflict between the decision below and the decisions of other state courts or the decisions of this Court and as the decision below was correct on the unique set of facts presented, plenary review should be denied.

ARGUMENT

POINT I

THE PETITION FOR CERTIORARI SHOULD BE DENIED BECAUSE THE DECISION OF THE SUPREME COURT OF NEW JERSEY DOES NOT CONFLICT WITH OTHER STATE COURT DECISIONS.

This Court has cautioned that its role in reviewing a state court decision involving the unitary business principle is limited to determining whether the lower court applied the correct standards and whether the result is "within the realm of permissible judgment." *Container*, 463 *U.S.* at 176. The Court pointed out:

> The legal principles defining the constitutional limits on the unitary business principle are now well established. The factual records in such cases, even when the parties enter into a stipulation, tend to be long and complex, and the line between 'historical fact' and 'constitutional fact' is often fuzzy at best. [*Ibid.*]

This is a good example of such a case. Bendix' long-term strategy of growth and diversification through acquisitions and divestitures, the role of the ASARCO investment in that strategy, and the relationship between the sale of the ASARCO stock and the continuation of that strategy in Bendix' attempt to acquire Martin Marietta present a complex, unique set of facts not conducive to a decision from this Court that would settle the unitary business issue. As the Supreme Court of New Jersey cogently concluded:

> Cases of this nature are the quintessential example of the tenet that facts, not principles of law, decide cases. [citations of authority omitted]. Our decision today should not be read beyond the scope of the facts of the case. [App. A at 24a].*

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* The courts of New Jersey have consistently adhered to this Court's admonition that unitary business cases turn on their facts. *ASARCO*, 458 *U.S.* at 326 n.22; *Container*, 463 *U.S.* at 175-76. *See e.g. International Paper Co. v. Taxation Div. Director*, 11 *N.J. Tax* 147 (Tax Ct. 1990, en banc), aff'd ___ *N.J. Tax* ___ (A.D. 1991), certif. den. ___ *N.J.* ___, ___ *A.*2d ___ (No. 33,784, Oct. 16, 1991) (holding that gain on the sale of a major subsidiary was unitary income but that gain on the sale of stock used as the convertibility feature in an issue of convertible debentures was not); *Mobil Oil Corp. v. Director, Div. of Taxation*, 11 *N.J. Tax* 344 (Tax Ct. 1990), app. pndg. N.J. Super. Ct. App. Div. No.

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Since the facts are so unique, the decision below is not in conflict with other state court decisions. For example, there was virtually no record evidence in *Corning Glassworks, Inc. v. Virginia Dep't. of Taxation*, 241 *Va.* 353, 402 *S.E.*2d 35 (1991), *cert.* den. 60 *U.S.L.W.* 3265 (Oct. 7, 1991, No. 90-1852), ___ *U.S.* ___, of a long-term, consistently pursued, operational strategy of buying and selling other corporations. Nor does the record explain how Corning's formation and sale of Owens-Corning Fiberglas Corp. were integral parts of any such operational strategy. To the contrary, the sale of Owens-Corning was forced upon Corning as the result of a consent decree under the antitrust laws. 402 *S.E.*2d at 36, 40.

Similarly, in *James v. Int'l Tel. & Tel. Corp.*, 654 *S.W.*2d 865 (Mo. 1983), the court found that "the record [did] not support the Director's contention that ITT [was] in the business of buying and selling subsidiaries." *Id.* at 868. That finding was decisive because the question under the Missouri income tax was whether the income in question arose "from transactions and activity in the regular course of the taxpayer's trade or business . . . . " *Id.* at 867. The sale in question was not in the regular course of

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A-2326-90T5 (holding that gain realized on an integrated oil company's forced sale of a minority interest in an oil producing company was not unitary); and *American Home Products Corp. v. Director, Div. of Taxation*, 11 *N.J. Tax* 287 (Tax Ct. 1990), app. pndg. N.J. Super. Ct. App. Div. No. A-4316-90T3 (holding that interest received on short-term interest bearing obligations was not unitary income because the underlying assets were not used as working capital).

ITT's business because it was part of a divestiture pursuant to a consent decree under the antitrust laws.*

Similarly, in *Pledger v. Illinois Tool Works, Inc.*, 306 Ark. 134, 812 *S.W.*2d 101 (1991), *cert.* den. 60 *U.S.L.W.* ___ (Nov. 12, 1991, No. 91-530), there was no evidence of an operational strategy involving the buying and selling of corporations and no evidence that the purchase and sale of the investments at issue were part of such a strategy. *See* 812 *S.W.*2d at 107 (Hays, J., dissenting). Moreover, as in *James, supra*, the issue in *Pledger* revolved around the question of whether the sale of the investments generated business income, *i.e.*, income arising in the "regular course of the taxpayer's trade or business . . . . " *Id.* at 102.

Likewise, in *Brunner Enterprises, Inc. v. Dep't. of Revenue*, 452 *So.*2d 550 (Fla. 1984), there was no evidence whatever of a persistent, integral corporate strategy of buying and selling other corporations. Brunner simply sold stock in an Illinois bank. *See Dep't. of Revenue v. Brunner Enterprises, Inc.*, 390 *So.*2d 713, 714 (Fla. 1980). Accordingly, the Florida court held that *ASARCO* precluded Florida's taxation of the investment income. 452 *So.*2d at 553.

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* The New Jersey Corporation Business Tax Act does not distinguish between business and nonbusiness income. Subject to constitutional constraints, all income is included in the tax base and apportioned according to the standard three-factor apportionment formula. *N.J. Stat. Ann.* § 54:10A-4(k) (West 1986) (App. D at 69a); *see Silent Hoist & Crane Co., Inc. v. Director, Div. of Taxation, supra*, 100 *N.J.* at 13-14, 494 *A.*2d at 781. Moreover, New Jersey does not permit combined reporting. *N.J. Admin. Code* tit. 18, § 7-11.15 (1991).

Petitioner is correct that there are differences among state courts in their application of the unitary business principle. Some states, including New Jersey and Maryland (*see e.g. NCR Corp. v. Comptroller*, 313 *Md.* 118, 133-41, 544 *A.*2d 764, 771-75 (1988)), analyze the manner in which an investment is used in an otherwise unitary business to determine whether the investment is unitary. Others, including Virginia, Missouri, Arkansas and Florida, analyze the relationships between the payor and recipient of investment income. This variation in approach does not create a conflict that needs to be resolved by this Court for "the unitary business concept is . . . not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." *Container*, 463 *U.S.* at 167.

The ultimate question is whether a particular investment is sufficiently connected to a taxpayer's otherwise unitary business to "render . . . formula apportionment a reasonable method of taxation." *Id.* at 166. The unique facts of this case establish that Bendix' investment in the stock of ASARCO was sufficiently related to Bendix' unitary business to justify formula apportionment. The fact that other state courts, on quite different facts, have found insufficient connections to justify apportioned taxation of investment income is not grounds to grant plenary review here. In an area as intensely factual as this one, the Court's general guidelines, set down in the early 1980's in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 *U.S.* 425 (1980), through *Container*, permit the states to adapt the unitary business principle to their particular statutory schemes and particular sets of facts. Where, as here, the

result is "within the realm of permissible judgment," there is no need for this Court's involvement. *Container*, 463 *U.S.* at 176.

POINT II

THE PETITION FOR CERTIORARI SHOULD BE DENIED BECAUSE THE DECISION OF THE SUPREME COURT OF NEW JERSEY IS CONSISTENT WITH THIS COURT'S DECISIONS.

In maintaining that the decision of the New Jersey Supreme Court is incompatible with prior decisions of this Court, petitioner overlooks the import of the Court's most recent decision on the unitary business issue in *Container* and the factual differences between this case on the one hand and *ASARCO* and *Woolworth* on the other.

In *Container*, the Court held that Container Corporation and its subsidiaries were engaged in a unitary business despite the absence of day-to-day operating control and "a substantial flow of goods" between parent and subsidiaries. *Container*, 463 U.S. at 177-180 and *n.* 19. The significant fact distinguishing Container's relations with its subsidiaries from Woolworth's relations with its subsidiaries in the *Woolworth* case was the fact that Container's management of the subsidiaries was grounded in its "operational expertise and its overall operational strategy." *Container*, 463 U.S. at 180 *n.* 19. In *Container*, this operational link between the parent's business and its investments in the subsidiaries provided the necessary "sharing or exchange of value not capable of precise identification or measurement – beyond the mere flow of funds arising out of a passive investment or a distinct

business operation . . . . " *Id.* at 166. The *Container* test ("some sharing or exchange of value") clarifies the holdings in *ASARCO* and *Woolworth* by establishing that active operational control and substantial flows of goods are not the only indicia of a unitary business. *Cf. ASARCO*, 458 *U.S.* at 322-24; *Woolworth*, 458 *U.S.* at 362, 364-67.

Additionally, the facts in *ASARCO* and *Woolworth* were quite different from those presented here. In *ASARCO* the trial court had found that "ASARCO's stock investments were 'not integral to nor a necessary part of [ASARCO's] business operation . . . . ' " *ASARCO*, 458 *U.S.* at 324 *n.* 21. As the Court was careful to point out, the facts before it differed "in critical respects" from those found in *Mobil*. *Id.* at 326 *n.* 22. There was insufficient proof in *ASARCO* that the investments were an integral part of ASARCO's operational strategy, and thus the record did not support Idaho's claim.

The record in *Woolworth* in support of the state's position was even less persuasive. There appear to have been virtually no proofs relating to Woolworth's business, its operations in New Mexico, the management of its subsidiaries, or the integration of the subsidiary investments into Woolworth's operations. *Woolworth*, 458 U.S. at 359 *n.* 7. On the records before it in *ASARCO* and *Woolworth*, the Court could not have found that the investments were so integrated with the taxpayer's day-to-day business operations that they should be treated as unitary investments.

When the New Jersey Supreme Court stated that Bendix "had a business function of corporate acquisitions

and divestitures that was an integral operational activity" (App. A at 18a - 19a), it was applying the *Container* test and relying on a record that demonstrates the existence of an acquisitions strategy beginning as early as 1965 and culminating with the demise of Bendix as a separate company, an operational strategy that permitted the company to diversify, to become more profitable, and to grow. *Container*, 463 *U.S.* at 180 *n.* 19. For instance, Bendix' acquisitions from 1965 through 1969 ranged from the automotive industry (one of the company's original businesses) to the machine tool industry (which by 1978 was part of a major operating group, the industrial-energy group) to unrelated diversifications such as United Geophysical Corporation, Texas Pipe Bending Company, and Skagit Corporation. Moreover, Bendix' Annual Reports to Shareholders frequently articulated the company's strategy of growth and diversification through acquisitions.

The record demonstrates that Bendix' purchase and sale of 20% of the stock of ASARCO was part of the same long-term operational strategy of growth and diversification through corporate acquisitions. Bendix viewed the ASARCO stock purchase as a diversification tending to insulate the company from cyclical trends in the economy, a strategy that the company had articulated and pursued in earlier years, and as an opportunity to expand its natural resources business, a business perceived as offering strong profit possibilities for the future. The stock was sold along with Bendix' other investments in natural resource companies when Bendix determined that its future profits lay in developing the high technology aspects of its business. In short, all of Bendix' investments, including its investment in ASARCO, aided in the

accomplishment of Bendix' operational strategies; none was purely "passive." *Container*, 463 U.S. at 166. All the investments provided flows of value, *id.* at 178, by broadening or diversifying the company's operations.

There is no merit in petitioner's argument that the decision below is inconsistent with decisions of this Court.*

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* Petitioner asserts (Pet. at 22) that New Jersey must establish a relationship between Bendix' activities in New Jersey and Bendix' investment in ASARCO. That is not what New Jersey must show. The unitary business analysis proceeds "by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world . . . . " *Container*, 463 *U.S.* at 165. If Bendix' activities in New Jersey are part of its unitary business (which no one disputes) and Bendix' investment in the stock of ASARCO is part of Bendix' unitary business, New Jersey may tax an apportioned share of the income arising from the ASARCO investment. *See Amerada Hess Corp. v. Director, Div. of Taxation*, 490 *U.S.* 66, 73 (1989). New Jersey need not show a direct relationship between Bendix' activities in New Jersey and its investment in ASARCO.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be denied.

Respectfully submitted,

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Dated: November 15, 1991

APPENDIX

BENDIX CORPORATION, Plaintiff, v. DIRECTOR, DIVISION OF TAXATION, Defendant.	TAX COURT OF NEW JERSEY DOCKET NO. 14-24-0504-84-CB Civil Action STIPULATION OF FACTS

. . . .

7. Bendix was incorporated in Delaware in 1929 as a manufacturer of aviation and automotive parts.

8. In 1937, Bendix obtained a certificate of authority to transact business in New Jersey and Bendix was qualified to transact business in New Jersey at all times relevant to this action.

9. In 1983 Bendix became a wholly owned subsidiary of Allied Corporation ("Allied") and was merged into Allied as of April 1, 1985.

10. At all times relevant to this action, Bendix's corporate headquarters and commercial domicile were in Southfield, Michigan.

11. Over the years, Bendix developed into a multinational corporation with activities, either directly or through subsidiaries or other operating units, in all 50 states and 22 foreign countries. Bendix's core businesses expanded along several basic lines so that beginning in 1970 (when the forest products business was acquired)

until 1981 (when the forest products business was sold) there were 4 major Bendix operating groups or sectors (the "Major Groups"): (a) automotive, (b) aerospace/electronics, (c) industrial/energy and (d) forest products. The various Bendix subsidiaries or other operating units were, for operational purposes, included by Bendix in one of the Major Groups based upon the type of business activity engaged in by that subsidiary or operating unit. Each subsidiary or operating unit had its own management which, in turn, reported to the chief executive of the Major Group in which the subsidiary or operating unit was included. The chief executives of the Major Groups reported directly to the chairman and chief executive officer of Bendix.

. . . .

13. The principal products manufactured by Bendix during 1981 are described in Bendix's 1981 annual report attached as Exhibit B. The business of Bendix Forest Products Corp. ("BFPC"), which comprised the bulk of the Bendix forest products business, is described in an excerpt from Bendix's 1979 annual report attached as Exhibit C.

. . . .

28. As described by A. Matthew Lord, Director of Corporate Development in the Bendix planning department, during his tenure in the planning department (1975-1982) Bendix had three major strategies for growth: (1) exploit its existing businesses, (2) move into related areas, and (3) move into unrelated areas with strong growth potential.

29. According to Mr. Lord, the long term goals for the Major Groups were:

> *Aerospace:* Move up on the scale to producing systems and sub-systems rather than products and components.
>
> *Automotive:* Offer more products, particularly in the after market, which is more profitable than the original entry market.
>
> *Forest Products:* Integrate forward and avoid the cyclical problems of the market.
>
> *Industrial:* Look for good growth potential and similar returns in different segments of the market.

30. As part of a shift in strategy which began in 1980 (see ¶¶ 154, 155 hereafter), the Bendix planning department's function included two additional endeavors. The first of these involved the formation of a technical ventures group, which evaluated and recommended certain relatively modest acquisitions in high technology businesses. The acquisition of 20% of Maxwell Laboratories, Inc. for less than $50 million and of E-O Tech were part of the technical ventures program. Not including Maxwell, the total dollar value of the acquisitions in the technical ventures program did not exceed $20 million. The second endeavor was a screening program to select a major acquisition candidate in a high technology business. Over a period of nearly two years, numerous companies were evaluated. One of the companies so evaluated was Martin Marietta Corporation ("Martin Marietta"). The Bendix planning group eventually recommended that Bendix consider the acquisition of Martin Marietta.

. . . .

31. At all times relevant to this action, Bendix's New Jersey activities consisted primarily of the operation of several Bendix units in the Aerospace Group at Teterboro, New Jersey, including Aerospace Flight Systems, Guidance Systems and Test Systems and the manufacture of electric power generating systems at a plant in Eatontown, New Jersey.

. . . .

38. At all times relevant to this action, Bendix also sold, both on a wholesale and retail basis, its full range of products to New Jersey customers and stored inventory in New Jersey at locations owned by others.

. . . .

39. Asarco (formerly known as American Smelting and Refining Co.,) was (and continues to be) a New Jersey corporation with its principal offices in New York, New York. At all times relevant to this action, Asarco was one of the world's leading producers of nonferrous metals, principally copper, lead, zinc and silver and nonmetallic minerals, including asbestos, coal, ilmenite and limestone. In addition to mining and treating ore from its own mines, Asarco at all times relevant to this action was a major custom smelter and refiner of nonferrous metal ores mined by others. Asarco at all times relevant to this action conducted its own operations in the United States, Canada, Peru, and Bolivia, and also had substantial investments in other mining and metals companies through which mining operations were conducted in Australia, Mexico, Nicaragua, Peru and other foreign

countries. These included M.I.M. Holdings Limited of Australia (48.9% owned), Mexico Desarrollo Industrial Minero, S.A. (34% owned), Neptune Mining Company (52.2% owned), Southern Peru Copper Corporation (52.3% owned), and Revere Copper and Brass Incorporated (33% owned).

40. At all times relevant to this matter, Asarco's sole activities (either directly or through subsidiaries) in New Jersey were the ownership of an ilmenite mine in Manchester, New Jersey, manufacturing by a subsidiary of additives, hardeners and other metal products at Newark and Trenton, New Jersey, manufacturing by a subsidiary of bronze rods, tubes, bearings, bushings and parts at Somerville, New Jersey, the rental of a management information service center in Cranford, New Jersey, the sale of its metal products to New Jersey customers and storage of inventory of such metal products at New Jersey locations owned by others. Asarco paid New Jersey corporation business tax with respect to these properties and income.

41. Prior to and after its investment in Asarco, no business or activity of Bendix (in New Jersey or otherwise), either directly or indirectly (other than the investment itself), was involved in the nonferrous metal production business or any other business or activity (in New Jersey or otherwise) in which Asarco was involved. On its part, Asarco had no business or activity (in New Jersey or otherwise) which, directly or indirectly, was involved in any of the businesses or activities (in New Jersey or otherwise) in which Bendix was involved. None of Asarco's activities, businesses or income (in New Jersey or otherwise) were related to or connected with Bendix's activities, business or income (in New Jersey or otherwise).

42. Prior to the decision to invest in Asarco, the Bendix planning department conducted studies of both natural resource companies and the non-ferrous metals industry. A copy of an executive summary of natural resource companies is attached as Exhibit D.

43. Bendix began buying shares of stock in Asarco on the open market in December 1977 and completed its acquisition of 20.6% of Asarco's stock in November, 1978.

44. The reasons for Bendix's interest in a natural resource company are set forth in a memorandum of March 31, 1978 from W.M. Agee to the Long Range Planning Committee of Bendix's Board of Directors entitled "Long Range Growth and Acquisition Planning," a copy of which is attached as Exhibit E. The memorandum was authored by Jerome Jacobsen, head of Bendix's planning department, with review and input from Mr. Agee.

45. The March 31, 1978 memorandum discusses the areas of Bendix's business which have potential for growth and sets forth strategies for growth in three of those areas. The memorandum also focuses on the possible acquisition of a nonferrous metals company and in particular Asarco (called "Blackie" in the memorandum), and provides reasons for acquiring approximately 20% of Asarco's stock. Attached to the memorandum are various supporting documents dealing primarily with the mining industry.

46. The Long Range Planning Committee of the Bendix Board of Directors recommended that the full Board of Directors approve the acquisition by Bendix of approximately 20% of the stock of Asarco.

47. The Board of Directors of Bendix met on April 13, 1978 and was presented with a memorandum dated April 12, 1978 from Mr. Agee requesting approval to purchase 15.1% of the stock of Asarco (4.9% having been previously acquired). A copy of an excerpt from the Bendix Board minutes of April 13, 1978, together with a copy of the memorandum of April 12, 1978 are attached as Exhibit F.

48. In addition to summarizing management's view that Bendix should acquire an interest in a company involved in basic commodities, particularly copper, the memorandum summarized Asarco's attributes, focused on the perceived unique aspects of the Asarco investment, outlined the broad parameters of the transaction, and set forth certain financial aspects of the investment.

49. Following presentation of the April 12, 1978 memorandum, the Bendix Board of Directors approved by resolution the acquisition of up to 21% of the stock of Asarco. A copy of the resolution is attached as Exhibit G.

50. Pursuant to a Stock Purchase Agreement dated as of April 13, 1978 (the "Agreement"), Asarco agreed to sell to Bendix 3,800,000 shares of Asarco stock. A copy of the Agreement is attached as Exhibit H. Under the terms of the Agreement, Bendix agreed that prior to January 1, 1985 it would not either directly or through subsidiaries and affiliates hold in the aggregate more than 21% of the voting stock of Asarco. Further, Bendix agreed that in the event prior to January 1, 1985 it desired to sell 1,000,000 or more shares of its Asarco stock, it would provide to Asarco a right of first refusal at a price and on terms set forth in the Agreement. Additionally, Bendix agreed that

prior to January 1, 1985 it would not solicit or permit any of its subsidiaries or affiliates to solicit proxies with respect to its Asarco stock or be, or permit any of its subsidiaries and affiliates to be, a "participant" in any "election contest" relating to election of directors of Asarco (as such terms are used in Rule 14a-11 of Regulation 14A under the Securities Exchange Act of 1934). The Agreement was to be governed by New Jersey law.

51. Through a series of further purchases either under option contracts or in the open market, Bendix acquired additional shares of stock of Asarco so that upon completion of all purchases it eventually owned 20.1% of such stock. Bendix maintained its investment in Asarco at a constant level of 6,106,900 shares which, upon retirement by Asarco of outstanding shares, became equal to 20.6% of Asarco's outstanding stock.

52. The total purchase price paid by Bendix for 20.6% of Asarco's stock was $127,649,017. The purchase price was paid by Bendix in cash, with $110 million of this purchase price being borrowed by Bendix under line of credit arrangements with its bank lenders. The balance of the cash purchase price was derived from internally generated funds.

53. While Bendix held the Asarco stock, Asarco agreed to recommend that two seats on Asarco's fourteen-member Board of Directors be filled by Bendix's representatives. These seats were filled by Mr. Agee and Malcolm Baldridge, a Bendix outside director.

54. Bendix did not exert any control over Asarco.

55. Because Bendix owned at least 20% of Asarco's stock, it was able to account for the investment under the equity method. Under this method, Bendix included in its income the share of Asarco's total earnings equal to Bendix's percentage of Asarco's stock, *i.e.*, 20.6%.

56. In order to report its investment in Asarco on the equity method, every fiscal quarter two or three individuals from Bendix's controller's department would visit Asarco's headquarters in New York and review Asarco's books and, at other times throughout the year, financial materials were supplied by Asarco to Bendix over the telephone or through the mails.

57. The Bendix Board of Directors met approximately five to six times a year. At every Board meeting during the period Bendix held at least 20% of Asarco, there was a report to the Board on Asarco's earnings. Copies of the relevant portions of certain Board minutes and Mr. Agee's reports to the Bendix Board on the Asarco investment at the meetings of October 26, 1978, February 12, 1979, April 26, 1979, June 18, 1979, October 25, 1979, January 31, 1980, April 24, 1980, June 26, 1980 and August 28, 1980 are attached as Exhibit I.

58. Over the years Bendix held its investment in Asarco, the economic outlook for the nonferrous metal industry greatly improved and the trading price of Asarco's stock increased as did its dividend payments.

59. The October 25, 1979 status report on the Asarco investment stated that Asarco contributed 82 cents per share to Bendix's earnings for Bendix's fiscal year ended September 30, 1979. Bendix's total earnings per share for fiscal year 1979 were $7.10.

60. The August 28, 1980 status report estimated that Asarco would contribute $2.22 per share to Bendix's 1980 earnings. Bendix's total earnings per share for fiscal year 1980 were $7.68.

61. With the approval of Bendix's Board, in September 1979, W.M. Agee made a proposal to Asarco's Board of Directors that the two companies consider a merger or other business combination. Asarco's Board did not wish to pursue discussion of any such transaction.

62. During the period that Bendix held its investment in Asarco, Bendix and Asarco were unrelated business enterprises each of whose activities had nothing to do with the other. As examples of this independence:

- There were no common management, officers, or employees of Bendix and Asarco.
- There was no use by Bendix of Asarco's corporate plant, offices or facilities and no use by Asarco of Benidx's corporate plant, offices or facilities.
- There was no rent or lease of any property by Bendix from Asarco and no rent or lease of any property by Asarco from Bendix.
- Bendix and Asarco were each responsible for providing their own legal services, contracting services, tax services, finance services and insurance.
- Bendix and Asarco had separate personnel and hiring policies . . . and separate pension and employee benefit plans.
- Bendix did not lend monies to Asarco and Asarco did not lend monies to Bendix.

- There were no joint borrowings by Bendix and Asarco.

- Bendix did not guaranty any of Asarco's debt and Asarco did not guaranty any of Bendix's debt.

- Asarco had no representative on Bendix's Board of Directors.

- Bendix did not pledge its Asarco stock.

- As far as can be determined there were no sales of product by Asarco itself to Bendix or by Bendix to Asarco. There were certain sales of product in the ordinary course of business by Asarco subsidiaries to Bendix but these sales were minute compared to Asarco's total sales of $1.7 billion in 1979 and $1.8 billion in 1980. The amounts of these sales are set forth in Exhibit J. These open market sales were at arms length prices and did not come about due to the Bendix investment in Asarco.

- There were no transfers of employees between Bendix and Asarco.

63. In the fall of 1980, Bendix publicly announced that it was considering the possibility of selling its stock in Asarco. On October 7, 1980, Mr. Agee reported to the Bendix Board of Directors on his discussions with Asarco concerning the possible sale of Bendix's stock in Asarco to Asarco. While two members of the Bendix planning department testified that they did not conduct studies involving disposition of the Asarco investment, the Board was presented with and discussed materials presented by a managing director of Lehman Brothers concerning a possible sale of Bendix's stock in Asarco. The Bendix

Board then authorized Mr. Agee to enter into an agreement to sell all or a portion of the Asarco stock at no less than $53 per share. A copy of an excerpt from the Bendix Board minutes of October 7, 1980 and an excerpt of the materials presented by Lehman Brothers are attached as Exhibit K.

64. Among the reasons for selling Bendix's interest in Asarco were (i) Bendix had decided to reduce its investment in businesses tied to natural resources such as BFPC and Asarco, and (ii) Bendix's investment in Asarco had appreciated considerably.

65. Asarco had a right of first refusal under the Agreement if Bendix desired to sell more than 1,000,000 shares of stock of Asarco. Upon negotiations with Bendix, Asarco agreed to repurchase its stock from Bendix.

66. On October 29, 1980, Bendix and Asarco entered into an agreement under which Asarco agreed to repurchase the shares owned by Bendix at $55 per share. The sale agreement was to be governed by the laws of New Jersey, and the closing was to occur in Morristown, New Jersey, at the offices of counsel of Asarco.

67. In the first half of 1981, Bendix sold its 6,106,900 shares in Asarco back to Asarco at $55 per share for a total sale price of approximately $335,879,500, of which approximately $211,500,000 was the long term capital gain at issue in this matter.

. . . .

69. In 1965, Bendix purchased 100% of the stock of UGC for stock in Bendix valued at approximately $6.2 million. Bendix sold 100% of the stock of UGC in July

1981 to Seiscom Delta, Inc. for cash amounting to approximately $80 million.

70. The purchase by Bendix of UGC was part of an effort by Bendix to diversify. It was also hoped that the business of UGC would complement existing Bendix oceanic endeavors. Bendix's 1965 Annual Report to Shareholders states at page 3:

> We have accelerated our acquisitions program. Here our objective is not merely diversification. We intend to achieve a better balance of our military and commercial-industrial product sales. We intend to enhance and improve our competence in the fields where Bendix's leadership and talents are acknowledged by acquiring strong units that are supplementary. In May [1965] we acquired the United Geophysical Corporation. This well-established organization is active world-wide in providing geophysical services to oil companies. Complementing our substantial oceanics endeavors, this acquisition will enable us to participate more fully in geophysical operations for petroleum and other minerals on a global basis.

71. UGC was in the business of seismic surveying, which involves the creation of underground acoustical waves through blasting or mechanical means and the recordation and interpretation of the wave patterns for purposes of locating oil and gas. A more detailed description of UGC's business is set forth in a draft prospectus dated June 18, 1981, an excerpt of which is attached as Exhibit L. UGC's principal customers were oil and gas companies.

72. UGC transacted no business in New Jersey.

73. Prior to acquiring UGC, neither Bendix nor any subsidiaries or affiliates were involved in the business of seismic surveying.

. . . .

117. Bendix placed the proceeds from the sale of its 20.6% interest in Asarco and its stock in UGC in an interest bearing investment account (the "Account") with Lehman Brothers. The Account was administered, and all securites on deposit were located, outside of New Jersey.

. . . .

124. In Late January 1981, Bendix made a public offer, valid until February 27, 1981, to purchase up to 4,000,000 of its shares at $64 per share and reserved the right to purchase an additional 1,000,000 shares.

125. As reflected in the filings made by Bendix with the Securities Exchange Commission in connection with this offer, the source of funds for the purchase of shares was the proceeds of Bendix's sale of its interest in Asarco and various subsidiaries.

126. Withdrawals from the Account in March and early April, 1981 were most likely used to pay for Bendix's purchase of its stock.

127. Bendix spent a total of $257.5 million on the purchase of its shares.

. . . .

128. Over the years Bendix engaged in selective acquisitions and divestitures of companies or assets of companies. While there were different reasons for each Bendix acquisition or divestiture, a major theme in this

area, as expressed by Mr. Lord, a senior member of the Bendix Planning 'Department during Mr. Agee's tenure, was whether an acquisition or disposition would enhance the existing product areas of Bendix. For example, a logical off-shoot of the businesses engaged in by the Automotive Group was the acquisitions of Fram Corporation (which made automotive oil and air filters) and Autolite (which made spark plugs). These two acquisitions were designed to expand Bendix's reach into the automobile "after market". Intended to broaden Bendix's product offering in the automotive field was the acquisition of Toledo Stamping and Manufacturing Company, a producer of engine rocker arms. The acquisition of Warner & Swasey Company enhanced Bendix's position in the machine tools business.

129. While Bendix owned BFPC, its forest products business, acquisition of Bass & Co. (retailer of specialty building materials), Caradco (maker of wood windows and doors), Modern Materials (maker of aluminum building products) and Coin Millwork (maker of moldings) was accomplished because these companies were involved in the manufacture, sale and distribution of products that utilized forest products as raw materials.

130. Bendix, on occasion, invested in or made an acquisition in business areas in which it had no existing specific involvement. Examples of this sort of activity included the purchase of UGC, BFPC, Skagit Corporation and the Asarco minority stock interest.

131. Suggestions for acquisitions or divestitures might come from various sources from within Bendix

including a group or division's/strategic plan, the planning department or from senior management. If an acquisition or divestiture was considered, the analysis of the impact of that transaction upon Bendix and the relative merits thereof might be performed by the division or group from which the idea emanated or by the Bendix planning department. The controller's department generally would conduct financial analysis of the proposed transaction. Once all analysis and evaluation of the transaction were completed, the proposal would be presented to the chairman for review. No acquisition proposal or divestiture could be presented to the Bendix Board of Directors without the approval of the chairman.

132. Bendix's 1966 Annual Report to Shareholders lists the following acquisitions at page 5. (The acquisition's principal business is indicated in parentheses):

- Besly-Welles Corporation (grinding machines and metal cutting tools)
- P & D Manufacturing Company, Inc. (automotive ignition parts)
- Fonda Gage Company (precision gage blocks for the metalworking industry)
- Beck-Lee Corporation (medical electronics equipment for doctors)
- Scully-Jones Company (tool holders and cutting tools for machine tools)
- Marine Advisors, Inc. (applied oceanography)
- Mosaic Fabrications, Inc. (fiber optics producer)

133. Bendix's 1967 Annual Report to Shareholders lists the following acquisitions at page 9:

- Fram Corporation (manufacture and sale of filters for internal combustion engines)
- Macklin Co. (grinding wheels for the automotive, glass, and steel industries)
- Titan Abrasives Company (abrasive grinding disks for the cutting tool industry)
- Industrial Fabricating Company (heat exchangers)
- Texas Pipe Bending Company (minority interest; manufacturer of welded pipe for refineries, chemical and petrochemical plants)

134. In 1967 Bendix disposed of its Marine Division.

135. Bendix's 1968 Annual Report to Shareholders lists the following acquisitions at page 30:

- Fram Corporation purchased the shares of Superior Machine & Tool Co. (manufacturer of tools and dies).
- Certain assets of Roberts Toledo Rubber Co. (molded rubber products).
- Consolidated Vacuum Corp. (vacuum systems for industrial processing and scientific and research laboratories).
- Fram Corporation purchased Mercury Filter Corp. (industrial air filters).
- Geo Prospectors, Inc.

136. The Chairman's letter in Bendix's 1969 Annual Report to Shareholders recounts the history of Bendix

which began as an aviation corporation supplying military systems, and states:

> Recognizing the vital necessity to broaden the base of our business so as to be less dependent on the government sector, we intensified our efforts to expand in other commercial and industrial markets.

Page 4 of the same Report states:

> Acquisitions have played a significant role in the growth of your Corporation during the past decade.

137. Bendix's 1969 Annual Report to Shareholders lists the following acquisitions at page 13:

- Buhr Machine Tool Company (automatic transfer machines).
- American Abrasive Company (abrasive grains, powders and wheels).
- Skagit Corporation (logging equipment and systems and other handling equipment).
- Fram Corporation purchased Superior Filter Glass Corporation.
- Remaining 49% of the stock of Bendix-Westinghouse Automotive Air Brake Co.
- Remaining stock in Aviation Electric Ltd.

138. During 1969 Bendix disposed of:

- Computing Devices of Canada Ltd.
- Bendix's Semiconductor Division
- UGC sold its Houston data center

- Bendix's Scientific Instruments and Equipment Division sold its dosimeter business.

139. The Chairman's message in Bendix's 1970 Annual Report to Shareholders states that Bendix merged with American Forest Products Corporation during that year. This was Bendix's largest acquisition to date and represented a new market for Bendix. American Forest Products Corporation was in the timber management, lumber, building materials, wood and corrugated containers, and aluminum siding businesses.

140. Bendix's 1971 Annual Report to Shareholders at page 33 mentions six relatively small acquisitions during the year and the acquisition of 50% interests in two European companies.

141. The Chairman's message in Bendix's 1972 Annual Report to Shareholders states that Bendix is pursuing "broad corporate strategies to further increase the non-government segment of our business, to pursue the diversification of our major lines of business, to expand our role in non-cyclicial or counter-cyclical markets and to increase our international involvement."

142. During 1973 Bendix acquired Boise Cascade's international mobile home and recreational vehicle businesses and reorganized these activities as Bendix Home Systems. During calendar year 1973 Bendix acquired the Autolite spark plug manufacturing facility and the Autolite trademark from the Ford Motor Company.

143. Bendix's 1973 Annual Report to Shareholders at page 1 discusses "the principle of diversification" and

states that Bendix's markets and products "are not necessarily on the same business cycles." The 1973 Report states further at page 1:

> We also continued our policy of disposing of minor operations which do not relate to our long-range business strategy.

144. Bendix's 1975 Annual Report to Shareholders states at page 8 that one of the principles followed at Bendix "has been the careful diversification of the Company into four broad lines of business – automotive, aerospace-electronics, industrial-energy and shelter."

145. The 1975 Annual Report states that pursuant to an order of the Federal Trade Commission certain operations of Bendix and Fram Corporation were transferred to a new subsidiary, Facet Enterprises, which would be divested no later than November 1976.

146. The letter to shareholders in Bendix's 1976 Annual Report states that Bendix's earnings record in the fifties and sixties was "spotty" due to excessive dependence on government work and on "the cyclical ups and downs of the industries [Bendix] served".

147. Bendix's 1977 Annual Report to Shareholders states in the letter to stockholders that "we have pursued a deliberate policy of diversification both within and among our lines of business, and geographically as well, in an effort to arrive at a combination of activities that helps insulate the company as a whole from the ups and downs of any one of them." Page 3 of the Report states that Bendix's acquisitions program has been a source of growth. This was the first of Mr. Agee's reports as chairman of Bendix. The Report notes at page 2 that one of the

keys to Bendix's reputation for reliability and high quality is its technological strength. During 1977 Bendix acquired Coin Millwork, a maker of wood moldings.

148. The chairman's report in the 1978 Annual Report to Shareholders states that Bendix has "successfully pursued a strategy of diversification that has brought us resistance to the ill effects of swings in the business cycle. First, we are in four major businesses: automotive, aerospace-electronics, forest products, and industrial-energy. Second, within each of these, we are also diversified."

149. During 1978, Bendix acquired Toledo Stamping and Manufacturing Company, a manufacturer of engine rocker arms for cars and trucks, and two small companies manufacturing components in the aerospace-electronics area of Bendix's business and sold the North American Manufactured home and recreational vehicle operations of Bendix Home Systems.

150. The chairman's report in Bendix's 1978 Annual Report to Shareholders reports the "single largest investment" in the company's history – the acquisition of 18.4% (ultimately to become 20.6%) of the shares of Asarco. Page 8 of the Report states that the acquisition of an interest in Asarco "strengthens Bendix for the 1980's with a substantial diversification into nonferrous metals and minerals."

151. The letter to stockholders in Bendix's 1979 Annual Report to Shareholders states at page 3 that one "strong element" in Bendix's strategy has been "a policy of diversification aimed at insulating the Company's total profitability from the cyclical troubles of any particular

industry or business" and that another element in the strategy has been a "careful effort to seek out the high return, high-growth segments of the markets [Bendix] serve[s]."

152. During 1979 Bendix acquired Bass & Company, a producer and distributor of building materials, and the Caradco Division of Scoville, a producer of windows and sliding doors.

153. During 1980 Bendix acquired Warner & Swasey Company, a machine tool manufacturer for $300.7 million, Bendix's largest acquisition to date, and sold Skagit Corporation for $28.3 million.

154. In 1980 there occurred certain changes in strategy at Bendix. The basic thrust of this revised strategy was to focus more heavily upon the high technology aspects of Bendix's existing businesses and to examine acquisitions of companies in high technology businesses that either might complement those existing Bendix businesses or represent an entry into new areas. In addition to these efforts, Bendix established an Advanced Technology Center to undertake basic research and exploratory development.

155. As part of this shift in strategy, there was a reevaluation by Bendix of its natural resource group which included BFPC, UGC and other companies and, for administrative purposes only, the Asarco investment. It was determined that continued involvement in these industries was not necessarily consistent with Bendix's desire to concentrate more significantly on developing its own technological capabilities and on companies which would assist in that effort.

156. Consistent with these decisions and the shift away from the natural resource businesses, during its 1981 fiscal year (10/1/80-9/30/81), Bendix disposed of or agreed to dispose of:

- BFPC for $435 million.
- UGC for $80 million.
- Bass, Caradco, and Modern Materials for a total loss of $12.5 million.
- Its 20.6% stock interest in Asarco for $336 million.

157. The sale of BFPC was consistent with Bendix's determination to reduce its involvement in businesses tied to natural resources.

158. Bendix's 1980 Annual Report to Shareholders states in the chairman's message:

> Our investment in the forest products business and Asarco were made in line with our policy of diversification as an insulator against the cyclicality of any particular business . . .
>
> When consummated, the sale of the forest products business and our interest in Asarco will reflect the basic soundness of investing in them originally; will increase the company's financial strength substantially; and will leave us well positioned to make prudent investments in the future of Bendix. As always, the overriding criteria for new investments will be the maximization of stockholder value.

159. The Chairman's letter in Bendix's 1981 Annual Report to Shareholders states at page 6:

> Finally, our redeployment of assets through our divestment program also contributed significantly to net income in 1981. We completed our plan for major divestments with the sale of our forest product business, our interest in Asarco Incorporated, and the stock of our subsidiary United Geophysical Corporation.

160. The 1981 Annual Report to Shareholders states at page 7 that the net gains from Bendix's various divestments "allowed the company to purchase some four million shares of our own stock which should enhance future shareholder value."

161. The cash proceeds from the various sales which took place in fiscal year 1981, created liquidity and additional debt capacity to enable Bendix to be in a position to make a sizable acquisition if an appropriate acquisition candidate materialized.

162. On August 24, 1982, Mr. Agee requested authorization from the Bendix Board to make a public offer to purchase up to 50% of the shares of Martin Marietta, with the intent of acquiring the remaining 50% in exchange for Bendix shares. Attached as Exhibit U is a copy of Mr. Agee's memorandum of August 24, 1982 proposing acquisition of Martin Marietta (called "Georgia" in the Exhibit). Bendix subsequently increased its offer to purchase up to 70% of Martin Marietta's stock.

163. Martin Marietta's principal business was aerospace related, where it was a prime contractor producing entire systems, with a strong involvement in the production of missiles. Bendix had an aerospace group with a

primary focus in aircraft, and was primarily a subcontractor of component parts. Bendix believed the businesses of Martin Marietta and Bendix were complementary.

164. Bendix purchased approximately 70% of the stock of Martin Marietta. The total cash purchase price for the Martin Marietta stock was slightly in excess of $1 billion and, with the assumption of Martin Marietta's debt, approached $1.5 billion. According to Bendix's 1982 Annual Report to Shareholders, Bendix incurred additional debt of $793.7 million and, decreased its cash and marketable securities by $424.1 primarily as a result of its purchase of the common stock of Martin Marietta.

165. Although Bendix succeeded in acquiring approximately 70% of Martin Marietta's shares, it was unable to call a meeting of the Martin Marietta shareholders before Martin Marietta acquired 50.3% of Bendix's shares. Allied then (1) purchased all the Bendix shares owned by Martin Marietta, (2) purchased all the Martin Marietta shares held by Bendix and (3) resold a large portion of the Martin Marietta shares to Martin Marietta. Allied then acquired the remaining Bendix shares through a merger, and Bendix became a wholly owned subsidiary of Allied.

[Signatures of counsel and dates]

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(3)

No. 91-615

Supreme Court, U.S.
FILED
NOV 21 1991
OFFICE OF THE CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Jersey

PETITIONER'S REPLY BRIEF

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TABLE OF AUTHORITIES

Page(s)

Cases

Amerada Hess Corp. v. Director, Div. of Taxation,
490 U.S. 66 (1989) 4

ASARCO, Inc. v. Idaho State Tax Comm'n,
458 U.S. 307 (1982) 3,4

Container Corp. of America v. Franchise Tax Bd.,
463 U.S. 159 (1983) 4

F.W. Woolworth Co. v. Taxation and Revenue Dep't,
458 U.S. 354 (1982) 3,4

Mobil Oil Corp. v. Comm'r of Taxes,
445 U.S. 425 (1980) 4

Pledger v. Illinois Tool Works, Inc.,
306 Ark. 134,
812 S.W.2d 101 (1991),
cert. denied, 60 U.S.L.W. 33595
(U.S. Nov. 12, 1991) (No. 91-530) 5

Virginia Dep't of Taxation v. Corning Glass Works, Inc.,
241 Va. 353,
402 S.E.2d 35 (1991),
cert. denied, 60 U.S.L.W. 3265
(U.S. Oct. 7, 1991) (No. 90-1852) 5

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PETITIONER'S REPLY BRIEF

Respondent's Brief in Opposition does not deny that this case raises an issue of profound national significance regarding the constitutional limitations on the power of the states to tax multistate enterprises. It takes issue only with the other two points raised by Allied-Signal Inc. ("Allied-Signal") in its petition for certiorari—namely, that the decision below conflicts with the decisions of other state courts of last resort and that the decision below is incompatible with the controlling decisions of

this Court. Neither of Respondent's contentions can withstand analysis.

I. THE ALLEGED "UNIQUENESS" OF THE FACTS OF THIS CASE CANNOT OBSCURE THE CONFLICT IT CREATES WITH THE DECISIONS OF OTHER STATE COURTS OF LAST RESORT

Just a few months ago the New Jersey Attorney General joined a brief to this Court urging this Court to consider the issue raised by this case because this case created a conflict with the decisions of other state courts of last resort (*see* Petition for a Writ of Certiorari ("Pet.") at 13-14). He has now purportedly discovered that this case no longer creates such a conflict. The reason is that the case is allegedly "unique." Thus Respondent suggests that there is now no conflict with these other state court decisions "[i]n light of the unique record" of this case (Brief in Opposition ("Opp.") at 12), because it presents "a complex, unique set of facts" (Opp. at 14), and because "[t]he unique facts of this case" (Opp. at 17) make it "a fact-bound case not appropriate for plenary review."

Respondent's revised view of the case is little more than a smokescreen designed to obscure the clear conflict between the decision below and the decisions of other state supreme courts. Indeed, Respondent fails to explain how the decision below is any more "unique" or "fact-bound" than any of the other cases that routinely appear on this Court's docket for decision on the merits. Moreover, Respondent cannot conceal the sharp division between the highest courts of Virginia, Arkansas, Missouri, and Florida, on the one hand, and New Jersey, Maryland, and Colorado, on the other, as to the appropriate *legal standard* to apply in deciding cases that raise the same issue. *See* Pet. at 9-13.

In fact, even Respondent concedes that "Petitioner is correct that there are differences among state courts in their application of the unitary business principle." Opp. at 17. Those "differences" reflect an irreconcilable conflict that this Court should resolve.

State tax collectors who have prevailed in the state courts may understandably seek to defeat this Court's review of the merits by asserting that their case is "unique" and "fact-bound" and accordingly "not appropriate for plenary review." But there is nothing unique or fact-bound about this case. Unless the sky is to be the limit in the taxation of multistate corporations that undertake to grow by diversification, this case brings to the fore the most fundamental questions of principle. If the constitutional limitations enunciated by this Court are to continue to have meaning with respect to diversified multistate corporations, then this New Jersey judgment should be reversed.

II. THE DECISION BELOW IS INCOMPATIBLE WITH THE DECISIONS OF THIS COURT

Respondent's effort to reconcile the New Jersey Supreme Court's decision with this Court's decisions in *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation and Revenue Dep't.*, 458 U.S. 354 (1982), is unavailing. He seeks to distinguish the facts of those cases from the instant case while ignoring the fundamental principle for which those cases stand, namely, that the Court cannot "accept, consistently with recognized due process standards, a definition of a 'unitary business' that would permit nondomiciliary States to apportion and tax dividends '[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in

the taxing State.'" *ASARCO*, 458 U.S. at 327 (*quoting Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 442 (1980)).[1]

Nor can Respondent derive any comfort from *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). The Court's decision in *Container* had nothing to do with the apportionability of income from a minority investment in another corporation and, in any event, was pointed out by the Court to be wholly "consistent" with *ASARCO* and *Woolworth*. 463 U.S. at 176 n.15. Indeed, *Container* lends powerful support to Petitioner's case by making it clear that the critical question regarding the apportionability of income is whether "the out-of-state activities of the purported 'unitary business' [are] related in some concrete way to the in-state activities," *id.* at 166, a standard that Bendix's relationship to ASARCO fails to meet.[2]

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[1] The Court also held that this principle applied equally to capital gains, which are at issue here. *ASARCO*, 458 U.S. at 330; Pet. at 19.

[2] For this reason, Respondent's reliance on *Amerada Hess Corp. v. Director, Div. of Taxation*, 490 U.S. 66 (1989); Opp. at 21 n.*, is entirely misplaced. The issue in *Amerada Hess* was whether New Jersey could deny the nation's major integrated oil companies a deduction for federal Windfall Profit Taxes in computing their net income for New Jersey corporate income tax purposes. Since the taxpayers were concededly conducting a unitary business from wellhead to gas pump, *id.* at 73, their income was apportionable by New Jersey in any event, and the only question was whether a particular cost of earning admittedly taxable income had to be allowed as a deduction because the cost was allegedly incurred outside the state. The Court found that the costs of generating unitary income are *by definition* no less unitary than the income itself, *id.* at 74, because "the resulting net figure is still a unitary one." *Id.* Here, by contrast, Bendix's unitary business being conducted in New Jersey has nothing to do with its investment in ASARCO, except insofar as the court below

Footnote Continued ...

CONCLUSION

On October 7, 1991, shortly before Allied-Signal filed its petition for certiorari, this Court denied certiorari in No. 90-1852, *Virginia Dep't. of Taxation v. Corning Glass Works, Inc.*, 60 U.S.L.W. 3265, and subsequently, on November 12, the Court denied certiorari in No. 91-530, *Pledger v. Illinois Tool Works, Inc.*, 60 U.S.L.W. 3359. Needless to say, this Court knows—and the Bar can only surmise—the various reasons why certiorari was denied in those two cases. But we submit that a substantial contributing factor almost certainly was that in both *Corning* and *Illinois Tool Works*, it was evident that the highest state courts (respectively, Virginia and Arkansas) were correct in holding for non-taxability. In sharp contrast, as the petition for certiorari shows, here the Supreme Court of New Jersey is in square conflict with the results and reasoning of the Virginia and Arkansas courts (as well as in conflict with the decisions of other highest state courts); and, in addition, the Supreme Court of New Jersey is plainly wrong and is in conflict with

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Footnote Continued from Previous Page

sought to tie the investment to New Jersey by reference to "the intangible nature of corporate operations." Pet. App. A at 18a. Respondent's vague invocations of Bendix's overall corporate strategy plainly do not amount to the "concrete" link that this Court has required before a nondomiciliary state may include income from a taxpayer's out-of-state investment activity in its apportionable tax base.

landmark decisions of this Court. For the reasons set forth in the petition for certiorari and the additional reasons in this reply, certiorari should be granted.

Dated: November 20, 1991

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FILED
JAN 10 1992
OFFICE OF THE CLERK

(9)

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JOINT APPENDIX

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PETITION FOR CERTIORARI FILED OCTOBER 11, 1991
CERTIORARI GRANTED NOVEMBER 27, 1991

TABLE OF CONTENTS

Chronological List of Relevant Docket Entries ..... J.A. 1

Complaint, filed August 31, 1984 ..... J.A. 3

Letter from Mark S. Rattner to Mary R. Hamill, dated February 15, 1985 ..... J.A. 13

Excerpts from Transcript of the Deposition of W.M. Agee, dated August 21, 1986 ..... J.A. 14

Exhibit D-17 to Deposition of W.M. Agee (Memorandum from W.M. Agee to Long Range Planning Committee of the Bendix Corporation) ..... J.A. 87

Exhibit D-18 to Deposition of W.M. Agee (Memorandum from W.M. Agee to Board of Directors of The Bendix Corporation) ..... J.A. 119

Exhibit D-19 to Deposition of W.M. Agee (Reprint of newspaper article) ..... J.A. 133

Harbir Singh's Affidavit, dated June 19, 1987 with Report and *Curriculum Vitae* ..... J.A. 138

Stipulation of Facts and List of Stipulated Exhibits, filed June 22, 1987 ..... J.A. 152

Exhibit A to Stipulation of Facts (Corporation Business Tax Return of The Bendix Corporation) ..... J.A. 199

Exhibit B to Stipulation of Facts (Excerpts from the 1981 Annual Report to Shareholders of The Bendix Corporation) ..... J.A. 211

Exhibit C to Stipulation of Facts (Excerpt from the 1979 Annual Report to Shareholders of The Bendix Corporation) ..... J.A. 227

Exhibit D to Stipulation of Facts (Executive Summary of Natural Resource Companies) ..... J.A. 231

Exhibit I to Stipulation of Facts (Reports on the ASARCO Investment) ..... J.A. 234

Exhibit U to Stipulation of Facts (Memorandum from W.M. Agee to Board of Directors of The Bendix Corporation) ..... J.A. 264

Order Admitting Report of Defendant's Expert, filed December 7, 1987 ..... J.A. 273

The following opinions have been omitted in printing this joint appendix because they appear on the following pages in the appendix to the printed Petition for Certiorari:

Opinion of the Supreme Court of New Jersey, July 16, 1991 ..... 1a

Opinion of the Superior Court of New Jersey, Appellate Division, October 19, 1989 ..... 25a

Opinion of the Tax Court of New Jersey, June 30, 1988 ..... 45a

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

August 31, 1984	Complaint (Corporation Business Tax) filed in the Tax Court of New Jersey.
October 22, 1984	Answer on Behalf of Defendant Director, Division of Taxation filed.
January 21, 1988	Proceedings before the Honorable Lawrence L. Lasser, Presiding Judge, Tax Court of New Jersey.
June 30, 1988	Opinion filed by Honorable Lawrence L. Lasser, Presiding Judge, Tax Court of New Jersey, directing Clerk of the Tax Court to enter judgment [text printed in Appendix C to Petition (the "Petition") for a Writ of Certiorari at 45a].
July 27, 1988	Judgment Affirming 1981 Deficiency Tax Assessment of the Director, Division of Taxation filed.
August 25, 1988	Notice of Appeal to Superior Court of New Jersey, Appellate Division filed.

October 19, 1989	Opinion and Judgment of the Superior Court of New Jersey, Appellate Division filed [text printed in Appendix B to the Petition at 25a].
November 8, 1989	Notice of Appeal to the Supreme Court of New Jersey filed.
July 16, 1991	Opinion and Judgment of the Supreme Court of New Jersey filed [text printed in Appendix A to the Petition at 1a].

Tax Court of New Jersey

Docket No. _____

BENDIX CORPORATION
Plaintiff,
vs.

DIRECTOR, DIVISION OF TAXATION
Defendant.

Complaint
(Corporation Business Tax)

Plaintiff Bendix Corporation ("Bendix"), a corporation organized under the laws of the State of Delaware and having its principal office and commercial domicile at Bendix Center, Southfield, Michigan, seeking a reduction in the tax assessment made by the Director of Division of Taxation in a Final Determination dated June 4, 1984, a copy of which is attached hereto as Exhibit A ("Final Determination"), and also seeking a refund of taxes pursuant to a claim for a refund, which claim was also denied in the Final Determination says:

1. A. Bendix was unconstitutionally and improperly assessed additional Corporation Business Tax in the amount of $41,707.44 for the tax year ending September 30, 1980 ("Fiscal 1980"), together with interest of $7,507.34 (thru January 15, 1982) and penalty of $2,085.37.

B. Bendix was unconstitutionally and improperly denied a refund of $107,143.56 for Fiscal 1980.

C. Bendix was granted a refund of Corporation Business Tax of $495,656.39 for the tax year ending September 30, 1981 ("Fiscal 1981"), but was unconstitutionally and improperly denied an additional refund in the amount of $1,907,794.70.

2. The facts upon which Bendix relies in support of its position that the above assessment and denial of refunds were unconstitutional and improper are as follows:

A. During Fiscal 1980 and Fiscal 1981, Bendix had its principal office and commercial domicile in Southfield, Michigan.

B. On July 15, 1981, Bendix filed its New Jersey Corporation Business Tax Return for Fiscal 1980 (together with an approved New Jersey extension) showing a refund due of $127,942.00. On July 15, 1982, Bendix filed its New Jersey Corporation Business Tax Return for Fiscal 1981 (together with an approved New Jersey extension) showing a refund due of $2,403,451.00.

C. Subsequent to Bendix's filing of the Fiscal 1980 and Fiscal 1981 tax returns, Bendix was audited by the Division of Taxation. As a result of the audit, an initial Notice of Assessment dated November 1, 1983 was issued for the tax years Fiscal 1980 and Fiscal 1981 (the "Initial Notice"). A copy of the Initial Notice is attached hereto as Exhibit B. As a result of the audit, Bendix was assessed additional tax due of $41,707.44 for Fiscal 1980 together with interest (through January 15, 1982) of $7,507.34 and penalty of $2,085.37. Further, Bendix's claimed refund of $2,403,451 for Fiscal 1981 was reduced to $475,687.40, for a net refund due of $424,387.25 for the two taxable years combined.

D. The Initial Notice contains the following computation for the Net Income Tax Liability of Bendix in Fiscal 1980:

Adjusted Entire Net Income (Sch.A, item 36)	$41,206,469.00
Adjustments: Schedule A, item 35	4,889,360.00
Adjusted Entire Net Income—Revised	$46,095,829.00
Allocation Factor	8.504779%
Allocated Net Income	3,920,348.38
Net Income Tax Rate	8.625%
Net Income Tax Liability—Fiscal 1980	338,130.05

The "Adjusted Entire Net Income—Revised" includes a capital gain of $20,292,251 on the sale of Bendix's 100% stock interest in Skagit Corporation ("Skagit"). In preparing its tax return for Fiscal 1980, Bendix had also included the Skagit capital gain as the return was prepared and filed prior to significant decisions of the United States Supreme Court which hold that inclusion of such capital gains income would be unconstitutional because Bendix and Skagit did not constitute a unitary business. Based on the same Allocation Factor and Net Income Tax Rate, $148,851 of the Net Income Tax Liability for Fiscal 1980 is attributable to this capital gain.

E. The Initial Notice contains the following computation for the Net Income Tax Liability of Bendix in Fiscal 1981:

Adjusted Entire Net Income (Sch.A, item 36)	$56,835,028.00
Adjustments:	
Schedule A, item 35	267,351,914.00
Adjusted Entire Net Income—Revised	$324,186,942.00
Allocation Factor	7.980727%
Allocated Net Income	25,872,474.81
Net Income Tax Rate	9.0%
Net Income Tax Liability	2,328,522.73

F. The $267,351,914.00 added to Adjusted Entire Net Income in the Initial Notice consists of the following items:

1. Net Gain/(Loss) from the Sale of Stock and Securities:

Securities Account—Lehman Brothers	(320,703)
Sale of Asarco, Inc. stock	211,513,354
Adj. on 1980 Sale of Skagit Corp. stock	(554,514)
Adj. on 1980 Sale of BHS stock	(97,978)
Sale of United Geophysical Corp. stock	41,953,170
Sale of Bass and Company stock	(5,041,153)
Sale of Farnham Metallurgy, Inc. stock	(3,500,000)
	$243,952,176

2. Interest Income:

From Foreign Subsidiaries		
Fram Europe Limited	1,421,985	
Jurid Werke G.m.b.H.	445,088	
Industrias Bendix Sociedad Anonima Industrial, CyF	786,003	
Dexbin Limited	1,542,458	
Bendix Limited	1,734,613	
Other	443,125	
		6,373,272
From Domestic Subsidiaries:		
Texas Pipe Bending Company	1,093,945	
Bendix Forest Product Corp.	895,170	
United Geophysical Corp.	296,051	
Bass and Company	441,851	
Other	367,229	
		3,094,246
From Securities Account— Lehman Brothers		12,702,331

From Other Sources:

The Commodore Corporation Note (Sale of Bendix Home Systems, Inc.)	540,353	
Cabby A.B. Note (Sale of Digne S.A. and Bendix Caravanes (France) S.A.)	143,306	
Prospect Hill Resources, Inc. (Sale of Bass and Company)	451,000	
Other	95,230	
		1,229,889
		23,399,738
TOTAL		$267,351,914

G. The interest income Bendix earned in the Lehman Brothers Securities Account during Fiscal 1981 was primarily earned upon the proceeds from its sale of its stock of Asarco Inc. ("Asarco"), Skagit and United Geophysical Corp. ("UGC"). Interest income "From Other Sources" was received on the sale of stock of Bendix subsidiaries.

H. The "Adjusted Entire Net Income" includes $3,515,136 of dividend income attributable to Bendix's stock holdings of Asarco and holdings of preferred stock of The Commodore Corporation ("Commodore"), which amount reflects the 50% statutory exclusion of the total dividends attributable to such holdings. In preparing its tax return for Fiscal 1981, Bendix had included the Asarco and Commodore dividends in Net Income as the return was prepared prior to and filed within days after significant decisions of the United States Supreme Court which hold that

inclusion of such dividends would be unconstitutional because Bendix, Asarco and Commodore did not constitute a unitary business.

I. The sum of the amounts of the gain on the sale of Bendix's 20.6% stock interest in Asarco, the gain on the sale of Bendix's 100% stock interest in UGC, all interest income (except that which is labelled "Bass and Company", "Prospect Hall Resources, Inc." and "Other") and the dividends received by Bendix on its Asarco and Commodore stock is $278,582,963. Based on the Allocation Factor and Net Income Tax Rate in the Initial Notice, $2,000,965 of Net Income Tax Liability for Fiscal 1981 is attributable to these items.

J. Subsequent to Bendix's receipt of the Initial Notice, Bendix requested a conference by letter dated November 29, 1984. A copy of the letter is attached hereto as Exhibit C. A conference was held with Division of Taxation ("Division") personnel on April 27, 1984. Thereafter, upon review of written submissions by Bendix and Bendix's formal request for an adjustment pursuant to N.J.S.A. 54:10A-8, the Final Determination was issued by the Division. The assessment for Fiscal 1980 was unchanged in the Final Determination, while the amount of refund granted for Fiscal 1981 was increased to $495,656.39, for a net refund due of $444,356.24 for the two taxable years combined.

3. The said assessment and denial of refunds is incorrect for the following reasons:

A. The inclusion of the capital gain on the sale of the Skagit stock of $20,292,251 in Fiscal 1980 in Net Income together with the offsetting adjustment of $554,514 thereto in Fiscal 1981 is prohibited by the Due

Process Clause of the Fourteenth Amendment of the United States Constitution because Bendix and Skagit did not constitute a unitary business.

B. The inclusion of the capital gain on the sale of the Asarco stock of $211,513,354 in Fiscal 1981 in Net Income is prohibited by the Due Process Clause of the Fourteenth Amendment of the United States Constitution because Bendix and Asarco did not constitute a unitary business.

C. The inclusion of the capital gain on the sale of UGC stock in Fiscal 1981 in Net Income is prohibited by the Due Process Clause of the Fourteenth Amendment of the United States Constitution because Bendix and UGC did not constitute a unitary business.

D. The inclusion of interest income from foreign and domestic subsidiaries (except that which is labelled "Bass and Company" or "Other") in Fiscal 1981 in Net Income is prohibited by the Due Process Clause of the Fourteenth Amendment of the United States Constitution because Bendix and such foreign and domestic subsidiaries did not constitute a unitary business.

E. The inclusion of interest income from the Lehman Brothers Securities Account in Fiscal 1981 in Net Income is prohibited by the Due Process Clause of the Fourteenth Amendment of the United States Constitution to the extent the interest was earned from the proceeds from the sale by Bendix of the stock of Skagit, Asarco and UGC because Bendix, Skagit, Asarco and UGC did not constitute a unitary business.

F. The inclusion of interest income set forth above as "From Other Sources" (except that which is labelled "Other") in Fiscal 1981 in Net Income is prohibited by the Due Process Clause of the Fourteenth Amendment of the United States Constitution because such income was earned from proceeds of the sale by Bendix of stock of certain Bendix subsidiaries and Bendix and such subsidiaries did not constitute a unitary business.

G. The inclusion of the $3,515,136 dividend income from Bendix's Asarco and Commodore stock holdings in Fiscal in 1981 [sic] Net Income is prohibited by the Due Process Clause of the Fourteenth Amendment of the United States Constitution because Bendix, Asarco and Commodore did not constitute a unitary business.

H. In the alternative that this Court determines that any of the gains, interest income or dividends set forth in paragraphs 3A, 3B, 3C, 3D, 3E, 3F or 3G are properly includable in Net Income of Bendix, the net income is not fairly apportioned and thereby in violation of the equitable standards of apportionment established by N.J.S.A. 54:10A-8 and of the requirements of the Commerce Clause of the United Stated [sic] Constitution because the allocation factor does not reflect the receipts, payroll or property of Skagit, Asarco, UGC, Commodore or any other foreign or domestic subsidiaries of Bendix.

I. In the alternative that any of the gains, interest income or dividends set forth in paragraphs 3A, 3B, 3C, 3D, 3E, 3F or 3G are deemed properly includable in the Net Income of Bendix, the Director, Division of Taxation abused his discretion

pursuant to N.J.S.A. §54:10A-8 by denying Bendix's request to adjust the allocation factor to reflect the receipts, payroll and property of Skagit, Asarco, UGC, Commodore and the other foreign and domestic subsidiaries of Bendix.

4. The amount in controversy and the amount of refund claimed exclusive of penalty and interest each exceeds $2,000 for each of the tax years.

WHEREFORE, Bendix demands that (i) the assessment, penalty and interest be set aside for Fiscal 1980, (ii) a refund of $107,143.56 be granted for Fiscal 1980, (iii) a refund of $2,000,965 be granted for Fiscal 1981, and (iv) such other alternative or additional relief be granted as this Court deems just and appropriate, including without limitation if necessary, the adjustment of the allocation factors to include the receipts, payroll and property of Skagit, Asarco, UGC, Commodore and the other foreign and domestic subsidiaries of Bendix, and the recalculation of the tax for Fiscal 1980 and Fiscal 1981 based upon such adjusted allocation factors.

RIKER, DANZIG,
SCHERER & HYLAND
Attorneys for Plaintiff
Bendix Corp.

By /s/ Alvin Weiss
ALVIN WEISS
A Member of the Firm

Dated: August 30, 1984

(Proof of service omitted in printing)
(Exhibits to Complaint omitted in printing)

(Letterhead of Riker, Danzig, Scherer & Hyland
omitted in printing)

February 15, 1985

Mary R. Hamill
Deputy Attorney General
Richard J. Hughes Justice Complex
CN 112
Trenton, New Jersey 08625

Re: Bendix Corporation vs. Director

Dear Polly:

Confirming our recent telephone conversation, Bendix has determined that it will abandon certain issues raised in the complaint filed on their behalf. Specifically, Bendix will no longer contest the inclusion of capital gains in their 1980 entire net income resulting from the sale by Bendix of its interest in Skagit Corporation, nor will it contest the inclusion in Bendix's entire net income of certain dividend and interest income. The specific issues and contentions which are being abandoned by Bendix are contained in paragraph 3A, 3D, 3E (but only as that paragraph pertains to Skagit), 3F and 3G of the complaint. All remaining aspects of the action will continue as set forth in the complaint. Bendix will respond to the Director's interrogatories consistent with its decision to abandon certain of the issues as described herein.

Very truly yours,

/s/ Mark S. Rattner
Mark S. Rattner

MSR:rk
bc: Edward R. Koch, Esq.

Tax Court of New Jersey

Docket No. 14-24-0504-84-CB

Civil Action

(Caption omitted in printing)

DEPOSITION OF WILLIAM AGEE, a witness called on behalf of the Defendant taken pursuant to the applicable provisions of the New Jersey Rules of Civil Procedure, taken before Mary E. Phillips, Registered Professional Reporter and Notary Public in and for the Commonwealth of Massachusetts, at the Dunfey Hyannis Hotel, West End Circle, Hyannis, Massachusetts, on Thursday, August 21, 1986, commencing at 9:15 a.m.

APPEAREANCES [sic]:

RIKER, DANZIG, SCHERER, HYLAND & PERRETTI
(By Mark S. Rattner, Esq.)
Headquarters Plaza
One Speedwell Avenue
Morristown, New Jersey 07960
For the Plaintiff

Mary Hamill, Deputy Attorney General
David M. Katzenstein, Deputy Attorney General
Division of Law, Richard J. Hughes Justice Complex, CN 112
Trenton, New Jersey 08625
For the Defendant

MARY E. PHILLIPS
Registered Professional Reporter
P.O. Box 160, Sagamore Beach, MA 02562
(617) 888-6717

* * *

[p.3]

MS. HAMILL: I'd like to say a number of things on the record before we get started.

This is the deposition of William M. Agee. Mr. Agee is a nonparty witness in this matter since he is not employed by Bendix.

The deposition is taking place in Massachusetts because Mr. Agee is not subject to the jurisdiction of the New Jersey courts.

The parties have stipulated that the deposition transcripts will be admissible if offered into evidence without objection as to authenticity or as to the availability of the witness.

If there are objections we will state the objections for the record and reserve the resolution of any of the objections to the time of trial or argument.

We will mark the exhibits for identification and authenticate them if necessary. And they will be either stipulated by the parties or offered at the time of argument or trial if they are objected to.

And we will continue the numbering of the exhibits from the prior depositions. And the first exhibit that I would like to have marked for identification is the stipulation of the parties

[p.4]

allowing this deposition. This should be marked D-16.

MR. RATTNER: I have no problem with that procedure. I simply note that your narrative about what was in the stipulation conforms to the stipulation and

obviously that stipulation sets forth what we agree to I think in your narrative.

MS. HAMILL: It does.

(Stipulation marked as Exhibit No. D-16 for id.)

* * *

WILLIAM AGEE

having first been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION
BY MS. HAMILL:

Q. Can you state your full name for the record?

A. William M. Agee.

* * *

[p.9]

[MS. HAMILL:] Now, you say you became Chief Executive Officer in December of 1976.

And at that time what was the change in your responsibilities from being part of the office of

[p.10]
Chief Executive and having the responsibilities you have just outlined?

A. At the time the announcement of the Chief Operating Officer's assignment and becoming President of the company was made the office of the Chief Executive was no longer in existence.

All the operating units, the automotive group, the forest products group, the industrial group, and the automotive group, all of those operations began reporting directly to me.

And the financial functions that had previously reported to me became the responsibility of the Chairman.

But that period was short-lived because the Chairman was soon appointed by Mr. Carter, President Carter, in early December to become the Secretary of the Treasury.

Q. Early December of what year was that?

A. 1976. And I became Chairman and Chief Executive designated in December of '76. It became official in January of '77 when Mr. Bloomenthal was sworn in as the Secretary of Treasury.

And as a practical matter I operated as the Chief Executive of the company from early December of

[p.11]
1976 until I left the company on June 1, 1973—1983, sorry.

Q. 1983 you say?

A. Yeah, June 1.

Q. And then as—

A. Just for the record eleven years and six days.

Q. As Chief Executive Officer then once Mr. Bloomenthal was appointed and left for Washington I take it the financial units reported to you as well as the operating?

A. Yes, they did.

Q. So you had complete management responsibility for the company; is that correct?

A. Yes, ma'am.

* * *

[p.14]

[MS. HAMILL:] What were the views he communicated on strategies for growth that were appropriate for Bendix in his view when he was Chairman?

A. I think in order not to take up the entire day because the best way to describe it is that it's in all the annual reports that were put out in 1972 through 1976, various communications with shareholders and analyst meetings and so on.

And there is a plethora of those summarizing what was Mr. Bloomenthal's view as it related to how Bendix was going to be run and what was his basic philosophy.

And if I could succinctly but probably not do it justice it was to have balance diversification of the company.

It was to increase shareholder value. Be sensitive to people as well as profits. And to continue to have a thriving enterprise.

Q. Did Bendix make any major acquisitions while Mr. Bloomenthal was serving as Chairman?

And by major I mean—well, in excess of $20 million.

[p.15]

MR. RATTNER: You are talking from 1972 forward now?

MS. HAMILL: I am talking now through specifically the time that—yes.

Q. The time that you were present at Bendix through the time that Mr. Bloomenthal left the company?

A. If you defined major as over 50 million the answer to that was one.

If the answer is major of 20 million and more there is probably three or four.

Q. Could you just list them?

A. The largest one that was made under Mr. Bloomenthal and successfully completed was the purchase of Bendix of what became Bendix Home System.

And I think that purchase price was in the area of 70 or 80 million dollars, if I remember correctly.

MR. RATTNER: I'd like to preface this—and I am sure there will be other questions on this along these lines—with our objection to the relevance of the inquiry as to the acquisition and dispositions of Bendix throughout these years.

We don't feel that those questions or facts really bear any relevance to the issues in the case.

[p.16]

Rather than clog the record with objections to every question, because I am sure there will be many, I would like to note it as a continuing objection to relevance.

And Mr. Agee can answer to the extent the questions are limited and well-defined, you know, but I noted that before and I would just note it again.

MS. HAMILL: And I will note for the record our response which we will obviously argue later on is that we are looking at a company that in Mr. Agee's words just now one of the goals was balance diversification, maximization or increase in shareholder value and that these actions may well have been part of that strategy.

And we are looking at the strategy of Bendix and how the ASARCO investment and UGC investment fit into that strategy.

Q. What were the other acquisitions? Now, we are talking over 20 million — between 20 million and 50

million between the time Mr. Bloomenthal was Chairman—

A. I believe that one was the AUTOLITE acquisition of the AUTOLITE plant and supply contract from the Ford Motor Company was over $20 million.

[p.17]

And the other acquisition that comes to mind, and I don't believe I have forgotten any, was the purchase of 40 percent of Jurid, that's J-u-r-i-d, which was a plant in Hamburg, Germany that Bendix owned sixty percent of and we acquired the other part.

Now the precise purchase price of that I can't recall but that acquisition took place about '75. I don't believe there are any other acquisitions of consequence during his tenure as Chairman.

Q. When Bendix acquired what became Bendix Home Systems did Bendix have—what business, if any, of Bendix—what existing business at that time did Bendix Home Systems fit in with?

A. The closest related business at the time was American Forest Products which later became known as Bendix Forest Products.

Q. Right. Who was Chairman of Bendix prior to Mr. Bloomenthal?

A. A. P. Fontaine.

Q. And if you can remember from approximately when to what date was he Chairman?

A. He was Chairman from the spring I believe of 1965

[p.18]
until April of 1972.

Q. Did you have any contacts with Mr. A. P. Fontaine?

A. I did.

Q. And were those official contacts in the sense of your employment at Bendix?

A. The first time I met Mr. Fontaine was five minutes after I was elected Executive Vice President, Chief Financial Officer and Director.

Mr. Fontaine had retired one month before as Chairman of the company in CEO, but he remained on the Board for several years as Chairman of the Finance Committee.

So it was in the capacity as Chairman of the Finance Committee, former Chairman of the company and a fellow Director that I had contact with him.

Q. And would it be correct to say that as Chief Financial Officer you were the top management person on the management of the Board?

A. Mr. Bloomenthal was also on the committee so he might take exception to that characterization, but I was one of them, yes.

Q. Did Mr. Fontaine have occasion as being a member of the Finance Committee and a Director to discuss with you Bendix' strategies for growth and acquisition

[p.19]
while he was Chairman?

MR. RATTNER: You mean Bendix' strategies for acquisition and growth that were occurring at that time or just his own philosophy on what they might have been?

MS. HAMILL: I mean his philosophy when he was serving as Chairman of Bendix.

A. Yes.

Q. And what were those strategies that he communicated to you?

A. Well, again, I would preface it by saying that if you study the annual reports of the company from 1965 through 1972 it would pretty much reflect much better than I how he was perceiving and how he was managing the company.

Several things that do come to mind in addition to those that have already been stated is that when Mr. Fontaine became the Chairman of the company in '65 the company was heavily dependent upon aerospace products and government contracts.

As I recall something over 50 percent of our profits were government related.

And one of his principal objectives during the 60's was to allow the company or to grow the

[p.20]
company or to develop the company in such a way so that they would be less dependent upon government sponsored business.

And the stated goal that was said internally and I think from time to time externally is that he had a personal goal of trying to get the profits on and dependence upon government contracts from where it was in '65 down to in the area of no more than 20 percent of the company, because he felt it was not wise to be solely dependent on in effect one classification of a customer.

Now, obviously, he had similar kinds of objections in terms of people and profits and shareholder growth and so on which many managements do.

But the overriding objective that he had that would perhaps differentiate himself a bit from what I have described Mr. Bloomenthal is this dedication to become less reliant upon the government.

* * *

[p.26]
[MS. HAMILL:] Let's be a little more specific than that. For instance, was there a committee system?

Did you work through committees and how did that work?

A. The Board of Directors had ultimate responsibility for all major decisions of the company.

And without getting into each and every area there was a chart of executive approvals which spelled out matters of compensation—at that time expenditures, matters of research and development, matters of budgets and so on on which the Board had the ultimate approval.

For example, I believe every capital expenditure that was over a million or million and a half maybe two million it changed over time of any nature and the company had to go to the Board for final approval for any acquisition of consequence.

And consequence would be a few thousand dollars. And as a practical matter I don't think we had any acquisition at all that did not go to the Board of Directors for final approval.

[p.27]

The same would be true of a divestiture. So major matters—and I'd like to keep in that context—there was not a major matter of consequence that the Board of Directors did not ultimately approve.

As it related to the chain of command, if you will, and the decision-making process before that took place there was no capital expenditure that I am aware of over a hundred or $150,000 that was made while he was Chief Executive that I didn't either know about it and/or have to make a final approval of it even if it didn't go to the Board.

So let's say between a hundred thousand on up to a million or two and a half million, depending on the

type of capital expenditures, none that I am aware of were made without my approval.

There is not an acquisition that was made during my tenure of office that was not approved by me whether it was very small or very large.

And the same would be true of major personnel decisions, major research and development programs, all operating budgets and all strategic plans.

Now, as it related to below my level as Chairman, the person who ran the automotive group as

[p.28]
an example had a level to start of capital expenditures would be my level, if you will, and between his people—and again I don't remember if it was between 25,000 and 50,000 up to a hundred or 200,000 but in that area—that the automotive group person would approve and would go through. The same would be true of research and development, personnel changes and so on.

On acquisitions again, obviously, he who ran the automotive group or aerospace or industrial area or forest product would be involved in a review with their people, he would sign off on it before reviewing it with me and the corporate staff people.

The thing I am trying to say here without making it too long and involved is that capital expenditures of consequence, acquisition, divestitures, major changes in the makeup, major R and D programs and so on would basically be approved by me and in most cases the Board and in all cases, of course, whoever was responsible below that level.

And there were periodic reviews of budgets, periodic reviews of strategic plans, periodic operating reviews during the year.

And it depended on what we were talking

[p.29]
about.

Not a month would go by that we wouldn't be reviewing some, if not all, aspects of various operating groups or the company in totality.

* * *

[p.33]

[MS. HAMILL:] When you say Chief Administrative Officer, was that the Controller's function?

A. No. That was Charlie Donnelly at the time who had the legal personnel and labor relations. Charles F. Donnelly, a lawyer.

Q. No comment. I want to just phrase this next question in a certain way, and I have to back up a little bit.

As I think you know, we are talking here about whether the state of New Jersey can tax capital gains from the sale of Bendix' stock interest in ASARCO, capital gains from the sale of UGC, and interest income realized in a Lehman Brothers account in the proceeds from those sales.

And broadly labeling just for the sake of this next line of questions these transactions that gave rise to these gains and interest as investments and the transactions and the company that gave rise to the daily operating income as operations just for purposes of this line of questioning, was there any—

MR. RATTNER: Let me just preface that. We

[p.34]
—obviously this is your question and you can characterize it as you wish, it obviously doesn't make it so. I think with that let's hear the question.

Q. Let's hear the question borne out. While you were Chairman, was there any difference in the decision-making process that was used to arrive at a decision recording investments such as ASARCO or UGC or Lehman Brothers and decisions made in the operating area; that is, for the operating sectors of the company; such as, automotive aerospace?

MR. RATTNER: I'm not sure I understand what you are saying.

MS. HAMILL: I'm looking at decision-making.

MR. RATTNER: And he also described how acquisitions were part of a decision-making process which ultimately came through his office. You know, so you ask him how was the decision to—

MS. HAMILL: I am seeing if there was any difference. Maybe he will say yes, maybe he will say no. But I think the question follows up.

MR. RATTNER: The question is so broad and open ended I'm not sure—

MS. HAMILL: I don't think it is broad and

[p.35]
open ended.

MR. RATTNER: Why was Lehman Brothers thrown into that?

MS. HAMILL: Because it is part of the issue in the case.

MR. RATTNER: Why don't you narrow the question?

MS. HAMILL: I can't narrow the question. Let's see if he can answer it or if he can't answer it.

Let's see if he knows what I am getting it at. Sometimes these witnesses know better what I am getting at than you do, Mr. Rattner.

MR. RATTNER: They are smarter than I am.

A. You have several categories in there in terms of the ASARCO situation.

To the best of my knowledge in the time I was with Bendix all during the time I was with Bendix until the ASARCO investment took place there had not been a decision like ASARCO.

ASARCO was different in my mind. And it was a major transaction.

It was the largest transaction that had been made during—again, this '72 to '78 period at that

[p.36]
stage.

It was a nonoperating situation because it was an investment in a company that had specific limitations attached to it.

In terms of how that decision was arrived at it was different because I was the architect of the idea, and I had some staff people help me with the idea.

But there was no natural resource group other than forest products. And of course, they didn't know the mining business.

And so the way that decision originated was with me with some staff help in analyzing that area, and it was approved by the Board.

But it is different in the sense that nothing had been decided like that during my tenure.

Maybe Vincent Bendix had something about that in his time or something and Earnie Breach but during my time it was case.

In the case of United Geophysical, I wasn't there when that company was acquired, but in terms of how the decision was made to divest of it that decision was similar to the way we made other divestment alternatives and decisions.

[p.37]
Again some of the operating people were involved, but it was mainly a corporate decision that was made and—

Q. Excuse me. A made corporate decision, do you mean Planning Department or CEO?

A. No me, CEO. Trying to differentiate again between operations and corporate decisions.

As an example, somebody who wanted to acquire a little company in the aerospace or automotive would say here we have a plan. This is going to fit in and so on.

UGC at the time it was sold was part of the aerospace group, but they didn't make nor were they advocating that we sell that particular operating group. That decision was made by me.

And I didn't involve the operating group until the decision had been run through the Board that, yes, we were going to sell it.

And so if you take those two as an example, those were corporate decisions principally made by me with some corporate staff support. And obviously they were agreed to and ratified and approved by the Board.

Q. When you say the decisions were made by you and that

[p.38]
is basically the decision to buy ASARCO and a decision to sell UGC, was there any input into your decision from the Bendix Planning Department?

A. Oh, sure, yes. As it related to ASARCO, Jerry Jacobson and his people.

But mainly Jerry had done some analysis for me on the nonferrous minerals business.

And as a matter of fact done a couple of studies for all the companies in that industry, and we narrowed it down to two, Kennecott and ASARCO.

And we bought positions in both before we ultimately did what we did.

Q. And how about the decision to divest UGC? Was there any involvement of the Planning Department in that decision that you recall?

A. And I have to say planning and financial department.

Q. Yes.

A. Both were involved because we didn't decide until the very last moment whether we would.

At one time we had serious consideration whether we would take this company public and remain a part owner in the company.

And so there was extensive work by the legal department as well as the finance department and the

[p.39]
Planning Department in the means of divestiture there.

Q. How about the decision to sell ASARCO. Was that your decision?

A. Absolutely.

Q. And again, did the Planning Department have a role or the finance—

A. No. No role in that. And the reason for that just a quick history is from the time we acquired the ASARCO position until the time we sold it it was on everybody's mind who knew anything about Bendix.

What are they going to do next? Are they going to acquire more? Are they going to keep it? Or are they going to sell it?

And if I said it once I said it 500 times when asked the question, What were you going to do with is a ASARCO? From the day we bought it until the day we sold it I had at least every day I would get a question on that.

And my answer was always the same. We have three alternatives as it relates to ASARCO. Buy more, sell it or hold it.

And I can assure you we are going to do one of those things. And that was the answer from the

[p.40]
beginning until the very end and it remained that way. It was different.

Q. Did you every consider the possibility of buying more in ASARCO?

A. I did and I tried to.

Q. Can you describe that a little, if you will?

A. I had extensive conversations with the Chairman and ultimately made a brief presentation to the Board of ASARCO.

And I believe it was either August or September of 1979 in which I proposed that we merge the two companies. And I was nicely but firmly and luckily turned down.

Q. And that was in what part of '79 did you say?

A. August, September of '79. I think it was early September. Maybe it was late September of '79, but I had conversations with Mr. Barber in August of '79.

And the Board—I can't recall if it was at the August or the September Board meeting.

I think it was probably September. And now that I recall I think their Board meeting was the last Tuesday or Wednesday of the month so that would make it late September.

Q. And I take it that the idea to acquire more stock in

[p.41]
ASARCO was something that you brought to the Bendix Board before making a proposal?

A. I did. I took it. It was approved by the Bendix Board. I'd have been in trouble a lot sooner if I hadn't—but I brought it to the Bendix Board in June of 1979 at a meeting, Board meeting in Paris. And it was approved by them to allow me to proceed with negotiations.

Q. At what point did you decide to sell Bendix' interest in ASARCO?

A. Well, the decision to sell was made in September 1980. I had contemplated it obviously during the entire time because there were really only as I said three options.

But the decision to sell I made that in September. And it was around the middle part, the latter part of September.

And I remember it well because we had agreed to sell the forest products group to Kohlberg, Kravis and Roberts.

We made that agreement in August of '80. And we announced it September of '80. And I knew that the world would want to know.

Well, now that you are getting out of forest

[p.42]
product what does that mean about ASARCO?

Because it was another natural resource albeit a different kind of investment. So I spelled it out at the time that we would consider selling the ASARCO position and

that was done in the mid-part of September. I think it was the 20 something of September.

Q. Was there any connection between the decision to sell ASARCO and the refusal of the ASARCO Board to be bought up, to have any more of its stock bought up by Bendix?

MR. RATTNER: I'm sorry, could you read that one back?

Q. Was there a connection in your mind between the rebuff, if you will, by the ASARCO Board and the decision to sell?

In other words, one of the three possibilities was no longer open to you. Did that color your view as to continuing to hold the investment?

A. Well, you never say never, okay. So I think it is hard to say that the acquisition of ASARCO was forever gone even though they said no once.

So in my mind that was a matter—they said

[p.43]
"no," but did it mean they couldn't say yes at a later date? You know, who knows for sure?

There had been a lot of time and a lot of distance between those matters. And in my mind I didn't think that because we were rebuffed now we are going to sell, no.

Q. Yeah, okay.

Q. Now Mr. Fee testified at his deposition that there was the thought I think he said—

A. Who is Mr. Fee?

Q. William Fee I think was in the controller's office.

A. Oh.

MR. RATTNER: I'm not sure Mr. Agee is familiar with Mr. Fee personally.

Why don't you ask him the substance rather than relating it to Mr. Fee's testimony.

MS. HAMILL: Mr. Fee made a statement and I wondered what Mr. Agee's view was on this. We were talking about the fact that Bendix I believe intended to take UGC public at one point and own as you say a share in the company, but it would be a public company.

And Mr. Fee said something to the effect that UGC could be made to stand alone and that was

[p.44]
part of Bendix' thinking.

Can you tell me what Bendix did to make UGC stand alone in connection with this possible public sale?

A. Okay. Just again for the record so there is no misunderstanding of the facts, it was one of the alternatives the company considered and that is to take it public.

But at no time did we ever make the decision that that's what the company was going to do for sure.

That was one of the alternatives that we were faced with.

UGC was a subsidiary, a separate subsidiary. It had operated separately for a period of time.

In the last five, six, seven years it had been part of the aerospace group. But it did not rely heavily upon the aerospace staff, although there was involvement.

It didn't rely heavily on the corporate staff, although there was some involvement.

It was closer to being a stand alone business than, let's say, an operating division of Bendix whether it be in aerospace, automotive or

[p.45]
industrial.

Because it was a subsidiary it had previously operated separately and it was relatively autonomous, because it was quite a different business than most of the central business of aerospace.

In order to make sure that—if we were to take this public there were certain things we had to do to in effect to make sure the management could stand on its own.

We brought in a stronger financial person as I recall and brought in an additional person or two or we were prepared to which would in effect allow that

company to—we are going to have to get a Board of Directors.

We had some conversations with people, so an independent Board of Directors would have to be there. And that's obviously a necessity for a public company.

So some of those steps were beginning to be taken and preparing the company for the possible public side.

Q. Now, I think you mentioned at one point these I think you said five-year strategic plans that were done by Bendix?

[p.46]

A. They were referred to as straps.

Q. And I'd like to get into the role that the strategic plans played in the decision-making process in just a little more detail. At what levels were they prepared?

A. From the smallest operating unit up. Take a small division of the aerospace group. They would prepare their own strategic plan.

It would be reviewed by the aerospace management, aerospace group.

And that would be made part of the aerospace group's plan.

And then they in turn—"they" being the aerospace group division and units would present it to the corporation.

And that would then be reviewed by corporate management and made part of the corporate strategic plan.

And this was true of all our major operating units of the company.

Q. When you say they were reviewed by corporate management, what specific functions within corporate management are you talking about now?

A. The plans. The personal review Chairman's Council or

[p.47]
whoever was reviewing it would be made by the Planning Department and would review, critique, summarize those plans.

And they would in turn present it to me and the group that was going to review it.

And then we would physically have a meeting of between one day and three days where we would interact with the operating people whosoever plan we were reviewing.

Q. Can you tell me in a general way what you expected to see in those strategic plans, what the contents were in a very general way, and I am looking at things like did they include strategies for growth for instance?

A. Oh sure. One of their requirements would be, you know, tell us as you can how well and what it takes to grow your businesses without any additional

capital, with more capital, with a lot more capital, with less capital.

And acquisitions would be presented in those, because some of the divisions would come in and say, We must acquire something in order to remain competitive.

Or if the corporation is going to say grow

[p.48]
at 10 or 15 percent over the next five years we can't do it given our existing base or we can do it but we need more money.

So it was the full spectrum. Grow as fast as you can with what you have, with what you would like to have.

Q. As a group would say we can only do it by an acquisition or words to that effect, would they name a particular acquisition candidate that they had in mind?

A. In some cases they would, yes.

Q. Then how were the plans used, acted on?

A. Well, it basically became when we would have these reviews, we would go back and forth.

Sometimes right in the midst of these meetings we would say we are with you go ahead and go in the following areas. You can count on this.

Or we would say we'd like to think about that. We will get back to you.

Or it is fine, go ahead and we will be monitoring it. Good luck and God bless.

Q. If it was an acquisition that was recommended?

A. If it was an acquisition that was recommended in some instances we would say sounds good.

[p.49]

Here's three candidates, go flush them out. When you have one that seems to make sense come back and talk to us.

Or alternately we'd say, Fine. If you are going to work on that find so and so from the Planning Department or so and so from the Finance or Planning Department and go and work with them and keep us tuned.

In other cases, We are not so sure about that. Don't spend any time on that.

Q. When you say "we" are you talking about you particularly or the Chairman's Council?

A. Mainly me, but I mean everybody was there and they were part of it.

In some cases I'd turn to Bill Purple if he was running the aerospace group. Hey, Bill, you run with this one. This is fine or whatever. The "we" meant the corporation.

* * *

[p.52]

[MS. HAMILL:] Now, I'd like to turn to Skagit for a minute. When was that acquired if you know?

A. It was in the late 60's maybe 1970, in that timeframe, while Mr. Fontaine was still Chairman.

He tried to acquire Hyster and they said no.

Q. What did Hyster make?

A. Lift trucks.

Q. Skagit made winches?

A. They had made logs and skidders and things that had hydraulic lifts attached to them. We always used to tease him a little bit that Skagit was Hyster on the rebound.

Q. What did you mean by that?

A. Well, again, you never know for sure. And the world it is full of second guessers.

But Skagit was not the most brilliant investment the company ever made. Any Hyster was a brilliant investment.

And there was disappointment that the company didn't get Hyster.

Q. Did Mr. Fontaine ever in responding to that say why he had bought Skagit, why Bendix had bought Skagit?

[p.53]

A. I think you can't zero in on Skagit. You have to understand during the period of the 60's and early 70's there was Skagit; United Geophysical; there was Scheffield a machine tool company in the Midwest in Ohio; there was Burr Machine Tool; there was American Forest Products and several other companies which were acquired which were all part of Mr. Fontaine's program to develop a new dimension and achieve the objective we talked about a bit earlier and this was one of several.

Q. All right. Now, turning briefly to Bendix Forest Product. I believe that was acquired in 1970; is that your recollection?

A. '69, '70. Part of it started in '69. It was completed in '70.

Q. And it was known at that time as American Forest Products Company?

A. Yes, it was.

Q. And I take it Mr. Fontaine was Chairman at that time?

A. Yes, he was.

Q. And what was the business that Bendix got when it bought American Forest Products?

A. Trees, a lot of wonderful trees in the Sierras, some building materials distribution facilities, some

[p.54]
sawmills, plywood mill, two waste paper paper mills, three container plants, and the largest maker of lettuce, wooden lettuce boxes in California and an ownership position in a company that made wooden ladders called Larson Ladders and an ownership in modern materials which had aluminum siding for houses.

Q. When you say an ownership position are you saying a minority stockholding?

A. No. They owned most of it.

Q. I see. Okay. When Bendix acquired American Forest Products and it acquired those businesses you just listed, were those related to Bendix' existing businesses at the time? And again I am referring now to your knowledge through Mr. Fontaine specifically?

A. Well, I read all the papers. And I read what was said to the shareholders.

And the only relationship of consequence that the company felt at the time and talked about at the time—because Bendix was quite good in infrared technology.

We could understand how you could survey forests with greater degree of accuracy and because we had some laser technology we were going to apply

[p.55]
that to the sawmill so that we would make sawmills more automated and more efficient, because there is a lot of waste in sawmills.

And those were the two areas that "there was some kind of synergy."

But I think Mr. Fontaine would be the first if not the second person to say that it was basically an unrelated diversification with the exception of these two areas of potential synergy.

Q. Now, turning to the ASARCO acquisition. That acquisition took place—

A. The investment.

Q. The investment, yes, took pace in basically 1978; is that correct?

A. Absolutely.

Q. And ASARCO's business was generally nonferrous metals; is that correct?

A. Generally.

Q. Did Bendix' business at the time relate in any particular way to nonferrous metals?

A. No.

MS. HAMILL: I'd like to have an exhibit marked now. This is a memorandum dated March 31, 1978 with three attachments.

[p.56]

It is addressed to the members of the Long Range Planning Committee from W.M. Agee.

And could we have that marked. And that would be D-17.

MR. RATTNER: Could we just make sure we have all the pages to that and make sure we have all the attachments.

MS. HAMILL: Yes.

(Discussion off the record.)

MS. HAMILL: We have been off the record, and we realize that the attachments that we have on the exhibit that we are identifying may not be all the attachment that exist.

And we are going to go back and verify that. And the exhibit is intended to be the March 31, 1978 memo and all the attachments. And with that could we have that marked.

(Documents marked as Exhibit No. D-17 for id.)

Q. Mr. Agee, I show you what's been marked D-17 for identification. Do you recognize that?

A. It appears to be something that I put my name to, yes, ma'am.

Q. And it is a memorandum, is it not, to the Long Range

[p.57]
Planning Committee?

A. Of the Board.

Q. Of the Board. Do you want to take a minute or two to look it over?

A. If you would like me to.

Q. Just for you to be sure what it is.

A. Okay. I have thumbed it quickly.

Q. Does this memorandum set out your thinking on the reasons for buying an interest in ASARCO?

A. I am sure it does, yes.

Q. Was there anyone else who had any input into this memo other than yourself?

A. Oh, sure. Mr. Jacobson.

Q. And who was Mr. Jacobson?

A. He was Senior Vice President. I think he was Senior Vice President at that time and head of the planning area. And he was the principal author of this with my editing.

Q. And these studies that are attached to it just very briefly and what we have here, B-1, B-2; would those be things that Mr. Jacobson had gathered from various sources?

A. Yes.

Q. As authority for what he was saying in the memo?

[p.58]

A. Yes.

Q. Now, you said I think that the memo was addressed to the committee of the Board of Directors called the Long Range Planning Committee; is that correct?

A. Yes, ma'am.

Q. And you were a member of that committee, I take it, as management representative?

A. I think I was. I attended all the meetings if I wasn't a member.

Q. Now, the introduction to that memorandum on page one states 44 goals, if you will, I think for the 80's aimed at growth and diversification?

A. Yes, ma'am.

Q. Could you just take a look at those and would those reflect the company's—really sum up the company's goals for growth and diversification at that time; is that a correct picture?

A. At that time I am sure it reflects our thinking, yes. As a matter of fact we did all those. About three really don't fit when you look at it.

That's a rationale for the investment. One, two and four really represent what our current thinking was.

And three—I should have caught this with

[p.59]
Mr. Jacobson. Shame on me. That three doesn't really fit.

Q. So what you are saying is that you had these three goals but aside from those goals you wanted to invest in a basic resource.

Is that the gist of what you just said?

A. No.

Q. Why do you say this wasn't part of it?

A. The it was this was the part of the reason for investing here.

Just very quickly the rationale at that time as far as I was concerned was that the company's basic operations were well-funded in terms of R and D, were well-funded in terms of capital expenditures were concerned, and were meeting the objectives that they stated and what we thought was realistically attainable and again fitting within the overall philosophy of the company.

And the rationale for this particular investment at that time was that the company in my judgment was in a position that it had some excess capital available to it.

Our debt ratio was not as high as we felt was tolerable. And our current operations were being

[p.60]
funded well.

And we were looking for additional ways in which we could strengthen shareholder value and strengthen financially the company.

And the ASARCO investment fit very nicely into that rationale, because it was depressed which is the third point here.

That whole industry was and ASARCO in particular. And it was an opportunity to make an investment which would position us to either grow into it as we tried later unsuccessfully or in the meantime we could make a very good return for the shareholders.

Q. Now, you indicated I think that one reason then for making this kind of investment in ASARCO as stated in the statement, basic resources were depressed and you go on, I think they offer strong profit possibilities for the 80's. What went into that statement? What was your thinking on the strong possibilities?

MR. RATTNER: I think the memorandum goes on for 20 pages. And I am sure it sets out in detail why Mr. Agee and Mr. Jacobson may have felt that way. If you want him to paraphrase that memo that really

[p.61]

doesn't serve any purpose.

Q. If anything stands out in your mind.

A. I am sure it adequately covers it we felt it was a good area of good opportunity.

Q. I see you refer to Blackie?

A. Blackie was the code name for ASARCO. Do you want—

Q. No. We don't have to get into that.

A. Lot of nostalgia attached to it.

Q. Now, going on I think there is also expressed in the memorandum the idea that you would acquire 20 percent of ASARCO as opposed to a larger interest. Can you talk at all about why you fixed on 20 percent?

A. We had many discussions in terms of is it five, 20, 50 percent, a hundred percent.

And the decision we arrived at was that 20 percent was a substantial position but it wasn't a total commitment to the industry and to the company but it was significant enough to make a difference in terms of long term appreciation.

And, if you will, it was a compromise between the full spectrum of alternatives that we considered.

* * *

[p.65]

[MS. HAMILL:] Now, we have reviewed very briefly the acquisitions of interests in UGC, Skagit, Bendix and Forest

[p.66]
Products and ASARCO.

Did the ASARCO investment in light of those other investments represent the only time Bendix branched out into new areas in your view?

MR. RATTNER: Let's get a timeframe.

MS. HAMILL: I have put it in terms of going back to '65 and we have gone through—

MR. RATTNER: He can answer differently as to different timeframes and branching out—I'm not sure. Let's define that a little bit better.

MS. HAMILL: I think if Mr. Agee understands the question maybe he can answer it. And if he doesn't I will try to explain it more.

A. Well, I will try to repeat what I have already stated. To the best of my knowledge in the period of time from 1972 until March, April of 1978 there was no other investment or no other dimension of the company like ASARCO. That was unusual, in and unto itself from '77 until mid '78 timeframe.

Q. Now going back and starting with 1956 when UGC was acquired the 1956 to 1972 period?

A. To the best of my knowledge there was no investment similar in terms of a 20 percent with a limitation and all other things attached to ASARCO—there

[p.67]
was no investment like this even bordering on this in the '65 to '72 area.

Q. From the point of view now not so much of the structuring of the investment taking a minority position but from the point of view of Bendix going into new lines of business, was this ASARCO investment unique going back to 1965?

A. The only area that would be possibly slightly analogous would be the investment and ultimate acquisition of forest products.

The forest product I think as I recall that one correctly that the company was a two-stage merger transaction.

It was part cash and then there was some preferred stock as I remember.

And there was a time delay of several months.

But again forest products was an acquisition of a hundred percent of the company. And it was intended to be an operating unit of the company as opposed to a passive investment.

Q. From the point of view of branching out from Bendix' existing businesses at the time was there any kind of a—

[p.68]

A. That's what I said that's where the analogy possibly holds.

Bendix wasn't in the forest product business, wasn't in the natural resource broadly or narrowly defined, wasn't in the paper business broadly or narrowly defined. So that was a new dimension.

Q. But you're distinguishing—now you are saying you are not putting UGC or Skagit in that position. You find that there was a closer relation between UGC's business and Bendix' businesses?

A. I think there is really three parts to the answer of that.

First of all from an ownership side if you look at it from that point of view Skagit, United Geophysical and forest product were similar because it was a hundred percent acquisition.

All right. UGC and forest products were kept as separate subsidiaries.

Maybe Skagit was. I can't recall. Whether they were kept as a separate.

But they were a hundred percent owned and they were in the main operated on a separate autonomous synergy.

[p.69]

In terms of did we have a business like them previous to the acquisition of UGC, Skagit and forest products the answer is no, which would be again we didn't have anything like ASARCO previous to its acquisition except again natural resources broadly defined forest products.

But in no case and the reason why I tried to distinguish ASARCO—this was a situation where it was a passive.

We sat on their Board, but we basically didn't have any control. And we were limited in terms of what we could do in terms of acquiring more.

And we also had some restrictions in terms of what we could do in terms of unwinding our position.

We had to give them a 30-day notice. And they had the right to match whatever we could sell it to somebody else for. So that's where it was in and unto itself, different.

Q. Now, I'd like to focus a little on the dispositions of those four companies, ASARCO, UGC, Skagit, BFPC. I think I am right that BFPC were sold in 1980?

A. Yes.

Q. And we know from this case that UGC and Bendix'

[p.70]
interest in ASARCO were sold in 1981?

A. Yes, ma'am. But the ASARCO agreement was reached in 1980. It was actually, the culmination of the sale—the transfer of money didn't take place until '81.

From my point of view the deal was consummated in '80 and UGC was the only one consummated in '81.

Q. Okay.

A. Penzoil and Texaco notwithstanding.

Q. Now, I think we have—you did discuss the generation of the idea to sell UGC and to sell the stock in ASARCO, and am I correct in saying that it was basically your idea to get out of those companies?

A. Yes, ma'am.

Q. With some input perhaps from the Planning Department; is that correct?

A. Yes.

Q. When it came to the decision to sell BFPC, how was that decision reached?

A. Carefully and quietly. In the spring of 1980 we started some conversations with the ultimate purchaser of the property.

And it was really in the summer of '80 that

[p.71]
I decided that the price and the time was right.

And we reached that decision and took it to the Board and got their approval.

But it was without input from the staff of the company.

Q. No input at all? No Planning Department input?

A. Not from the Planning Department or the Controller's area.

Q. What made you think it was the time to sell Bendix Forest Products?

A. Forest products business for some period of time in my judgment we either had to get quite a bit bigger or we had to remove ourself from the business because we were kind of in between.

We were not fully integrated. And we were a regional forest product company. And we had tried on various occasions to make it bigger during the late 70's.

And in each case every acquisition seemed to be to me very expensive.

So logic dictates if everything out there is very expensive and you are not prepared to pay the price for it to get bigger and if you feel you have to get bigger or you are going to shrink, I guess

[p.72]
only one conclusion comes out of it if you think through this way, and that is you probably should divest.

It was not a mainline business for Bendix. And frankly the time was right and inflation fever was at an all time pitch, peak, fever pitch.

And the price we got was a price that I couldn't refuse.

Q. When you say the inflation fever was at an all time pitch, did that tie in, in your thinking, with what the price of the natural resources that BFPC—what might happen to pricing?

A. Absolutely. Because when you are talking to other companies—we talked to several other companies, quite a few other companies who were regional companies, similar to ourselves.

And when they were talking about values that I felt were inflated by a 50 to a hundred percent that tells you something about the overall market.

And as you recall in 1980 inflation psychology in this country was running rampant.

Interest rates were very, very high and people felt commodities resources were the only hedge against inflation.

[p.73]

And we happened to own a lot of trees. And they were very valuable.

And people put a tremendous premium on those because they were extrapolating on the future from my point of view.

And the price we did ultimately get was the highest price to my knowledge that's ever been paid for trees of this quality in the world. We got an all time price.

Q. But when you were thinking about inflation and the price and your decision to sell, was it your thought that the price was not going to hold up for these commodities or that these people were perhaps—

A. I had an economics professor who had a simplistic phrase. That ph ase was what goes up must come down.

And when everone [sic] thought the trees were going up I am enough of a contrarian to believe that life is not one extrapolation from here onward, and these things don't progress geometrically.

And one is the company was on a strategy and had been since the time I became President to grow and develop and do things that I was discussing.

And this would be a part of a natural reconstructing which I had been planning for a year

[p.74]
or two before.

So the time was right. And it fit in with our time to restructure.

Q. Was there enough of a drive up between trees and nonferrous metal that ASARCO was involved in—

MR. RATTNER: Are you asking if it was the same market between trees and nonferrous metals?

A. Some yes and some no. What I mean by that is commodity resources, natural resources in general were inflating during this period of time.

Trees rise in values, part of which was attached to the inflation psychology that existed and pervaded the entire economy.

But there were some separate forces within the copper business and the nonferrous metals business that was further accelerating and that is the demand/supply

relationship was very close to being imbalanced which is the difference in copper, through. True in any business.

The supply/demand in forest products wasn't as great. There was a bigger gap in copper.

Q. Was your concern or your thought that the market would come down in natural resources such as trees?

Did you have the same concern for nonferrous

[p.75]
metals and specifically the copper that ASARCO dealt in, was that one of the relations that motivated your decision to sell ASARCO is what I am really driving at.

A. Any decision that's this important is complex and it is difficult to reduce it to a couple or three reasons.

But as it relates to—once we made the decision to sell forest products, and we had a deal that was struck and we were satisfied with that price it was therefore natural that it would only accelerate peoples' interest in what are you going to do with ASARCO because there is now no other natural resource dimension.

Secondly, we were on the path of restructuring the company. And ASARCO had appreciated substantially and so that entered into it.

And thirdly some of the forces that were at play market-wise as far as copper prices and other nonferrous metals were concerned I did have a concern about their long-term trendline.

What they would do in the near term I didn't know. You never do. But as far as long-term

[p.76]
trendline I did have a concern about that.

So I think it was the convergence of several kinds of interlocking and interrelated decisions that caused us to consider that.

Q. Now, you mentioned a couple of times here a restructuring of the company that was going on. And just to tie it into something that we have had before in these depositions let's have this marked.

No. I'm sorry, this is not to be marked. This is an exhibit which was marked earlier. It is D-6 which is a letter on the stationery of Lehman Brothers Kuhn Lab [sic]. I show you D-6, Mr. Agee.

A. (Indicating.)

Q. Do you recognize that letter, Mr. Agee?

A. Yes, ma'am.

Q. Just briefly could you say what it is?

A. It is a letter from Pete Peterson who was the Chairman of Lehman Brothers addressed to me September 5, 1980 which spells out our fee arrangement on various transactions.

Q. Why did he discuss a fee with you?

A. Well, you don't want a long sermon on this.

Q. I just want to know the relationship between Lehman and Bendix.

[p.77]

A. Investment bankers in order to make a significant living they charge outrageous fees for their work.

And since we were going to do and were in the process of doing several transactions of which there was good reason to do it through one firm rather than several and to try and protect the shareholders of Bendix or we didn't pay them high fees, I had a long involved discussion with Mr. Peterson about what we would pay them for the work that they were to do.

And just parenthetically as I look at those percentages and compare it to some of the stuff that's out there today I wish Chief Executive Officers would be as cost conscious as some people in the past.

Q. The bottom of the page the first page it refers to an exciting restructuring job that you have embarked upon. Can you describe what that restructuring was?

A. I don't know what Mr. Peterson meant by "exciting," but I can talk to you about what restructuring meant.

We had made the decision, as I said earlier, we were discussing it in '79 and early '80.

And we made the decision that certain businesses would be sold and that we would emphasize

[p.78]
more high technology companies than we had in the past and that we would take some of those areas that were not in the mainstream of other business, nor did we think we could economically make them into the mainstream and we would sell those off.

And it also came under the major umbrellas. One of the areas I was trying to accomplish was to make the company less dependent profit-wise on the automobile business.

MR. RATTNER: I'd like to note for the record on the bottom on D-6 there is a line underlined. I assume those are your markings.

MS. HAMILL: I think I must have put them there.

THE WITNESS: Can I go off the record for a minute.

(Discussion off the record.)

Q. Now, Mr. Agee, you referred to selling off I think was the term you used the businesses which were not mainstreamed businesses in Bendix?

A. Or we could make into mainstream economically.

Q. Give us some examples of the non-mainstream businesses that you wanted to sell off?

A. Texas Pipe Bending, United Geophysical, Skagit,

[p.79]
Bendix Forest Products, ASARCO, these were all areas we considered and certain areas of the automotive group.

Q. Now, your interest in becoming less dependent on the automotive business, had that been a concern of your pedecessors [sic], the Chairmen that preceded you at Bendix?

A. No, not to the degree it was to me because as I have already testified that between 1965 and really 1976 the company went from being basically government dependent to being automotive dependent.

And so one of the things that I didn't spend a lot of time publicly talking about but the Board certainly knew my concern is I felt the company was too dependent upon the automobile.

And one of the things I hoped to accomplish while I was CEO was to make it less dependent upon the automobile or automobile, truck, automotive broadly defined.

Q. And then another thing I think you said was part of the restructuring you had in mind was a greater emphasis on high technology.

Did you have any particular areas that you were looking at?

[p.80]
A. Yes.

Q. What were those?

A. All of those that we later worked on that are a matter of public record.

Q. Martin Marietta?

A. RCA, Lockheed, General Dynamics, Gould, you don't need to have the whole list but that was.

Q. Yes. Am I correct that you took some stock positions in those companies that you just listed, Lockheed, General Dynamics, Martin Marietta and Gould?

MR. RATTNER: If I could note for the record that those situations for the most part occurred at a timeframe after the disposition of ASARCO and UGC.

And we have had this discussion before. We feel that there is really no relevance to go into events which occurred on those dates.

And with that as a background note my objection to it and continuing objection. And you set forth your position.

MS. HAMILL: I would state our response that we are looking at the way Bendix operated and its acquisition strategies.

And the final step in all of that was the attempt to acquire Marietta.

[p.81]

Therefore, even though it is after the year at issue it does have relevance and Judge Lasser has permitted questions—

MR. RATTNER: He has permitted—with documentation and whatnot.

A. And the answer to the question is yes.

Q. Let's go back to the question. The question that you are answering is that you took stock positions.

Did you take stock positions; is that what you are answering?

A. The answer to the question is still yes.

Q. Fine. Just while we are on the subject of Lehman Brothers and to finish up on that topic, as I understand it the proceeds from the sale of the stock in UGC and Bendix' 20 percent stock interest in ASARCO were put in an account at Lehman Brothers.

Does that correspond to your recollection, Mr. Agee?

A. Not exactly, no.

Q. Could you explain why?

A. Well, we had substantial funds that were coming in during that period of time at various times.

Some of the funds came directly into the Treasury at Bendix and were used for various

[p.82]
purposes.

And some of the funds were used for a money market short-term management account that Lehman Brothers had.

But I don't believe—and I could be stood corrected in my mind—all of the funds did not flow into Lehman. And all of the funds were not in that account.

We used it to purchase some Treasury stock which was a substantial program of over $3 million. We had to pay some taxes. We had various corporate and general purposes and then we had some excess cash that was left over from the divestiture program.

The excess cash was invested principally in the money market account which Lehman looked at with our concurrence.

But we also had some other investments which were made preferred stock of banks as well as some of these other equity investments that we later took which were managed out of the corporate office.

So it was a blend of all of those was the way the total restructuring program took place.

Q. Why did Bendix put any of the proceeds at all with Lehman Brothers in that money market account?

[p.83]

A. I just felt that with all of the matters going on at the time it was important that we had outside professional help executing orders because it was a substantial amount of money.

Other Treasury people had not developed a large expertise because we hadn't had a lot of excess funds up until then.

And for an organizational, administrative and control reasons it made sense to have professionals do that area that they were best at doing.

Q. Was that money market account liquid?

A. Again I haven't gone back and audited it. My recollection was it was supposed to be very liquid, meaning highly salable.

Q. So you could get the money out very quickly?

A. With one exception, yes. And that was a matter of great contention between myself and the Chief Financial Officer where they did not follow my orders.

But that's a separate story. But the short answer is yes.

Q. Okay.

A. Liquid to me meant less than 90 days. And in the

[p.84]
case I just referred to there were some maturities taken out beyond a year which was not pleasing to me because I wanted it to be highly liquid.

Q. Why did you want it to be highly liquid?

A. Because of what I felt interest rates were going to do and wanting the flexibility to move cash rapidly without a market loss assuming we needed the cash to proceed.

Q. Okay. Did you have any particular use of the cash in mind or—

A. Well, in terms of when you have that amount of cash interest rates are high and you are also looking at various acquisition candidates it is a balance between making sure your shareholders are getting a high return on the cash and at the same time you are ready to roll in terms of implementing an acquisition.

Also because interest rates were accelerating, at the time of interest rates accelerating if you believe that's going to take place you better be sure because you make more money, at least I think.

That's what they taught me at the University of Idaho.

[p.85]

Q. I'd like to go back to a couple of questions, Mr. Agee.

You mentioned in your idea of restructuring the company that you wanted to get a greater emphasis on high technology.

Why high technology? What made you go for high technology as opposed to something else that Bendix could have gotten into?

A. Well, you have to understand a good bit of Bendix was in high technology already.

The important part of the aerospace business was high technology.

My definition, you know, we could be here forever discussing what's high tech and what isn't.

But the bulk of aerospace was high tech. An important part of our automotive business base was high tech.

Q. What, out of curiosity—because I think of that as being not high technology.

A. Over the years Bendix was the originator of fuel injection which is today is the best system.

We pioneered that in the 60's and early 60's and fuel injectors, engine sensors, power brakes, radar braking.

[p.86]

All of these areas we were on the most advanced side of technology for braking and for ignition and for electronics in the car.

We were also the leading manufacturer of air braking systems including anti-skid braking systems which was the highest end of technology for braking trucks.

May sound kind of mundane to you, but when you are in the automotive business and you are trying to start and run a car more efficiently you were either on the

leading or lagging edge of technology. And we were on the leading edge.

The same is true for industrial machine tools. We had some of the most advanced transfer machines, flexible tools, robotics, et cetera.

So the part of Bendix that was not sold and the part that we were keeping and growing dramatically was on the leading or high end of technology for those businesses we served, a couple of exceptions to it but generally the bulk of the Bendix operations were there.

Q. Am I right when you have got the high technology aspect of a business you can expect a greater return on investment?

[p.87]

A. That's the hope.

Q. I mean that's why you would pick high technology as opposed to going into the lower end?

A. No. It is too simplistic. And it is more complicated than that. Normally companies that have priority products or especially those that tend to be leading technology rather than lagging technology at least historically they had served Bendix very well.

Good returns, good generation of jobs for our people and long-term security in terms of where you were in this world.

It is kind of grow or die is part of the American system whether you are on the high end or low end. And we wanted to grow.

Q. Was the feeling that the natural resource businesses and here I am talking about Bendix Forest Products, ASARCO, perhaps even UGC and Skagit had not done as well for Bendix historically?

A. Again you can't say that. In terms of operating income Bendix Forest Products had been okay, not brilliant, but in terms of total return over the period of time they owned it it was sensational.

Because we had a substantial income that was realized by the divestiture.

[p.88]

In the case of United Geophysical in the early years it was terrible. We lost our shirt. But including the value that the company got back at the time we sold it it was a very, very good return.

In the case of Skagit we had several good years in Skagit. We had several so-so years. And the price we got it for it was okay.

So total return from the time you bought it, operating income and the time that it left the company.

Q. But if you take into account what it gave you when it left the company and if you are comparing current operating results between high tech and forest products, UGC and leaving aside the potential sale which would have been your comparison if you decided to sell or not, wouldn't it, that you'd come out ahead with high tech is that—

MR. RATTNER: I'm not sure I understand. What's the question?

MS. HAMILL: I think he has understood the question. I am trying to focus on the decision to sell?

MR. RATTNER: Well, he told you the decision to sell was because there was an idea that some of

[p.89]
these businesses, the ones you mentioned were not mainline Bendix business, and it was time to go to move to some other areas.

You are trying to get him to tell you and I don't know whether this is a reality or not that, you know, in looking at the returns from those companies ASARCO, UGC, Skagit and forest products and factoring in what was realized on the sale was not a good return on some hypothetical high tech venture which we haven't even identified.

MS. HAMILL: True. I am looking at the thinking at the time.

MR. RATTNER: I don't know what the question is.

Q. I am wondering about the decision to sell the group of companies, Skagit, UGC, ASARCO, Bendix Forest Products.

And when you look at the returns, the operating returns you had had on those companies, how it compared to returns in the higher tech aspects of Bendix' business and whether that was a factor in the decision. That's all.

MR. RATTNER: If you are trying to get him to say—

[p.90]

MS. HAMILL: I'm not trying to get him to say anything, Mr. Rattner.

MR. RATTNER: By looking at the returns that it was a good idea to buy and sell businesses.

MS. HAMILL: Let's hear what he says. He may agree with you completely or he may not.

Or he may say it is much more complex than that as he has said many times.

MR. RATTNER: Let's start over again with the question. I don't mean to be argumentative, but I still don't understand the question.

MS. HAMILL: The question—

MR. RATTNER: Now this it has gone off to about 12 questions.

Q. I think we have said it about three times. The question is we were looking at the decision—Bendix' decision that it wanted a greater emphasis on high technology businesses.

MR. RATTNER: That was one of their acquisition thrusts.

Q. And the next question was why was Bendix moving in that direction and one of the ideas was that

perhaps there were greater profits to be—operating profits to be had in that line.

[p.91]

And then you come to the decision to sell certain companies.

Are you comparing then the operating profits that you would anticipate from the companies that were sold to the operating profits of what you might anticipate in high tech and even existing high tech businesses so that you get some—I'm looking for reasons why those companies were sold.

Now, we know that they were not core businesses, but was there also a concern that they were not as profitable on an ongoing operating business basis? That's the question.

MR. RATTNER: As what?

MS. HAMILL: As high tech, as the brakes and fuel injection, as the, you know, the high tech that Bendix had at that time.

A. It is a combination of several things. And again it is more complex than that.

But we had a concern about future stream of operating income from the businesses that we sold as it related to in some cases what they had done in the immediate past.

And in addition to that in terms of the return that we could get just investing it in

[p.92]
marketable securities at those interest rates at the prices we were able to sell those businesses.

So it was a combination of alternative returns with safety, along with not fitting a principal long-term strategy of the company.

And what weight that could put on those I can't tell you but those were some of the facts.

* * *

[p.96]
[MS. HAMILL:] Could you elaborate on that a little bit, the timing, for instance, of the Martin Marietta acquisition and what your ideas were and how it tied in with this obvious cash, large amount of cash that you generated?

A. Well, cash was part of it. But in terms of achieving the objective of new dimensions, high technology dimensions and the fact that there were various companies as I have already stated in here whether they were unrealized values or unrecognized values so all of those matters were there.

And during this period of time I think even

[p.97]
at this time I then in addition to owning 70 percent of RCA which I believe we did in April of '82 we had some minor stockholder positions in some of the other companies we have talked about.

Q. You mean Gould?

A. And I think we had sold Lockheed, Gould and General Dynamics.

I think we owned a little bit of that and we shortly thereafter started accumulating some Martin Marietta.

Q. Did the decision-making process that Bendix used to analyze the pros and cons of attempting to acquire Martin Marietta, were they the same or were they different from the analysis you had gone through?

A. They were similar in some respects but in some cases a bit more involved because of the idea that we may try to take a hundred percent of the company and that wasn't paramount at the time of the ASARCO.

Q. Did the Bendix Planning Department play a role in analyzing the Martin Marietta acquisition?

A. Yes.

Q. And did it make a recommendation?

A. They made many recommendations over time. And the way it took place is that we had generated a list of

[p.98]
15, 20, 25 companies in which we asked independent studies on each of those be made, and in some cases we asked them to rank them. In other cases we didn't ask them to rank them. And that was part of the input that we used, yes.

Q. And so I take it that Martin Marietta came out somewhere in the top of that rank?

A. Absolutely.

Q. Do you have any idea who did those studies on Martin Marietta?

A. Well, depends on which studies you are referring to. In the Planning Department.

Q. Yes, Planning Department is what I am thinking about.

A. I think Matt Lord and perhaps—well, Matt. I know he was the aerospace fellow.

And I am sure he worked on some of these. And Michael Rownay worked on them. And at one stage I think Larry Hastie, H-a-s-t-i-e.

Q. You might spell Rownay also for us.

A. R-o-w-n-a-y.

Q. Do you have any idea where those studies might be located?

A. I don't.

Q. Who made the ultimate management decision to

[p.99]
recommend the acquisition of Martin Marietta?

A. After all these hours you don't know the answer to that question, ma'am?

Q. The judge may not.

A. I think first the answer is I did. But in terms of recommendations I didn't view these studies as recommendations from these people as much as I wanted them to compare various companies and say how they felt about them.

But if somebody is saying, Well we recommend and therefore he did it. That just wasn't the way things worked.

Q. No one has said that, Mr. Agee, I assure you.

A. They get very defensive.

Q. They all say it was Bill Agee.

A. I made the decision.

Q. How if you wouldn't mind going into a little more detail, who [sic] would Martin Marietta have fit into the financial strategies and operational strategies outlined?

A. Very nicely.

Q. Can you elaborate a little bit on that specifically? I think the financial—if it fit into the financial strategies outlined in this memo?

[p.100]

A. First, we'd have to first go to the business. A large part of the business that Marietta were in were very

complementary and compatible with Bendix especially in aerospace they were prime contractors in many cases.

And we were a subcontractor. And a lot of our technology and management philosophies and businesses were complementary to one another.

In addition to that a part of the business that had not been run well in terms of the concrete business and the aluminum business and where they had spent hundreds of millions of dollars was an area in terms of restructures that we had demonstrated a good aptitude for handling.

And we felt we could help them out. And the way we tried to structure the transaction was that in such a way both shareholders both Bendix and Marietta would mutually benefit by the combination of the two companies.

Q. Would it be accurate to say that the cash that Bendix realized from the sale of Bendix Forest Products, Skagit, UGC and 20 percent of ASARCO played a role in the attempt to acquire Martin Marietta?

A. Yes, if you say played a role, certainly.

[p.101]

Q. What?

A. Well, obviously because of the liquidity that happened developed as a result of restructuring program it created both cash and debt capacity to allow us to grow in a fairly sizable way beyond the Bendix that was in existence then, combination debt capacity and excess cash.

Q. Would Martin Marietta have been Bendix' largest acquisition to that date?

A. Yes, absolutely.

Q. What sort of dollar amounts were you looking at very, very roughly? I just want to get a comparison.

A. Well, ASARCO was 120 something million. Warner and Swazey after netting out certain items was around 300 million.

Q. What was Warner and Swazey?

A. It was a machine tool company that was acquired in the fall, actually late fall, early winter of 1979, '80.

So that was the largest. And Martin Marietta when you assume the debt of Martin Marietta and all this it was probably a billion and a half dollar transaction. So on the order of five times the size.

[p.102]

Q. I'd like to go back a moment now to the ASARCO investment. And after all the investments that we have looked at, I think you have characterized once or twice the ASARCO investment as a passive investment?

A. Yes, ma'am.

Q. What do you mean by that?

A. No day-to-day or week-to-week management responsibility. The involvement that we had was at the Board level.

There was myself and one other Board member that sat in on the Board meetings and attended monthly.

And sometimes we'd miss a month or two. But it was a Board of Director involvement in the company as opposed to a management involvement.

Q. Was it like buying shares in a mutual fund or money fund? Was it that kind of passive investment?

A. Well, no. Because we had Board involvement.

* * *

[p.106]

MS. HAMILL: I am asking him specifically in his view what the ASARCO investment achieved for Bendix.

MR. RATTNER: I think you have in the record—but there are documentation as presented to the Board as to why it was an appropriate time to sell ASARCO and what the rationale was and that should basically serve—

MS. HAMILL: He was the Chairman at the time and he—

MR. RATTNER: I understand.

MS. HAMILL: And he authored it, initiated, made the decision to sell and made the decision to buy. And I'd like to know what he thinks it achieved.

MR. RATTNER: What he thinks what achieved?

[p.107]
The sale?

[MS. HAMILL:] ASARCO investment generally and obviously part of that is the sale.

A. Purchase the holding and the sale of ASARCO was a very attractive return on shareholders investment.

It served the shareholders well by returning to them a very high return on its investment.

And it also allowed the company an opportunity to learn more about the major business in this country which didn't go forward. And we achieved those two areas. Knowledge and the very good return to the shareholders.

* * *

[p.111]
[MS. HAMILL:] Now Bendix had two people on the ASARCO Board; is

[p.112]
that correct?

A. Yes.

Q. And did you have an influence on the ASARCO Board?

A. No.

Q. Did the ASARCO Board ever do what you and the other Bendix Director suggested they do?

A. Rarely, if at all.

* * *

[p.118]

[MR. RATTNER:] Did ASARCO rent or lease any property from Bendix?

MS. HAMILL: Excuse me. I will object to that. I don't know how in his capacity as Chairman he might have known whether there might have been a very minor lease of property.

MR. RATTNER: I think he can answer to his personal knowledge if he doesn't know of any. And if he wants to qualify it by something like that I have

[p.119]

no problem.

MS. HAMILL: You have to ask him first if he had any knowledge about that kind of a transaction. Would he have had that kind of knowledge?

You are talking about the Chairman. And he can't have dealt with nickels and dimes.

MR. RATTNER: He said that he talked about any capital expenditures of a hundred thousand dollars or more he would know about.

A. Maybe I can help if you don't mind. Anything and everything that had to do with ASARCO because I was the principal architect in buying it I was one of two Board members of Bendix.

In those days anything that happened to ASARCO and/or Bendix of an interrelation I am confident I would have known about just because of the nature and delicacy of the relationship.

And I know of none other than riding on their corporate plane once in Arizona actually from New Jersey to Arizona. And with a stop off in Corpus Christi, Texas.

There was never any reimbursement of expenses. And I never submitted expenses for Board meetings.

* * *

(Certification of court reporter omitted in printing)

(Exhibit D-16 omitted in printing)

EXHIBIT D-17 TO THE TRANSCRIPT OF THE DEPOSITION OF WILLIAM AGEE DATED AUGUST 21, 1986*

Office of
The Chairman and President

Bendix

Date March 31, 1978

To Members of the Long Range Planning Committee

From W. M. Agee

Subject Long Range Growth and Acquisition Planning

I. INTRODUCTION

We believe ourselves to be strong enough financially and managerially to warrant several major moves aimed at growth and diversification for the 80's.

- Growth and diversification in the Industrial/Energy area.
- Growth and rebalancing in the forest products area.
- Investment in other basic resources that are now depressed and undervalued but that offer strong profit possibilities for the 80's.

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* This memorandum was attached to the Stipulation of Facts (J.A. 152–198) in this case as "Exhibit E." (*See* J.A. 196). This document is cited in the Brief of Petitioner as "Exhibit E."

- Restructuring of Bendix Home Systems with a view to possible withdrawal in the next few years.

These actions might slow down somewhat the growth in our near-term earnings. But we would be building towards rapid growth in earnings in the early 80's.

We would be tilting our activities in the directions that may, on the whole, make us somewhat more cyclical than we have been but with compensating higher growth.

We would be well able over the period to keep our balance sheet within the 65/35 ratio that is so important to us. Each major acquisition would be structured to leave us positioned financially to take the next action.

We would probably face a significant increase in goodwill from acquisitions, but it is not entirely clear that this is so.

We would have no trouble in maintaining our growth in dividends.

The program that we have in mind would require some significant increase in our total capitalization. Part of this would come about in any case because we will generate an annual increase in net worth averaging approximately $100 million over the next five years. Leveraging this to the 2:1 debt ratio with which we are comfortable permits an increase in capitalization of over $300 million in the next two years and well over $750 million over 5 years. The use of preferred securities for acquisitions would, of course, strengthen our equity base

thus permitting further debt. The sale of common stock is also open to us.

We have given careful thought to these measures. Some of them would be viewed in financial and industrial circles as both conventional and expected. The departure into basic mineral resources would certainly come as a surprise. The number of actions coming within a fairly short period, and the fact that we may seek an equity position without control, would be out of keeping with the usual Bendix manner. Bendix has not made a major acquisition since 1972 and its one effort since—to acquire Excello—foundered.

All this is by way of providing perspective for the series of actions we will soon describe. But let us first describe where our present businesses are going.

II. STRENGTHENING EXISTING BUSINESSES

Four parts of our business are ripe for active sales growth while two of them are not. These two are:

- **Domestic Automotive (OEM)**—We do not wish to become relatively larger in the OEM area for it already dominates our domestic activities. We cannot hope to be significantly larger with Ford, our major customer, and, in fact, are fighting off stiff competition from home as well as from abroad. GM is not a major account nor is Chrysler and we cannot hope for significantly larger business from either of them—nor from American Motors. The desire of OEMs, particularly GM, for in-house integration is always a threat to us. Foreign manufacturers such as Volkswagen—or the Japanese if they come—will be marginal accounts for us.

Taking one thing with another we will be very content with annual *real* growth of 4-5% per annum, built mostly around strengthening our position in truck brakes and in automotive electronics.

• **Aerospace/Electronics**—This area is fortunate that commercial and general aviation markets will rise in the 80's, offsetting relatively declining military and space markets. Both government and commercial pricing pressures are rising and the competition is stiff. In real terms we can look for no better than 2-3% *real* growth with high-risk programs that we must continue to approach cautiously.

Now, consider the stronger areas:

• **Domestic Automotive Aftermarket**—Real growth of 7% per year can be hoped for. Fram has recently enlarged its capacity for both filters and spark plugs, and the challenge is to grow market share in the face of stiffening price competition and more suppliers in the relatively profitable and steadily growing aftermarket. In this market we are effectively barred from acquisitions.

• **Industrial/Energy**—

- The *machine tool* portion should have good success and be less cyclical while the automotive industry is converting to small, fuel-efficient vehicles. However, our narrow segment of the industry is relatively well populated and we cannot look for a strong growth. One year with another, 4-5% *real* growth is a good target. In the related field of automation and measurement, competition is severe, and recently we have yielded

market share but with new products and improved marketing we can hope for 4-5% *real* growth.

- The *cutting tools and abrasive parts* of our business cannot count on more than 3-4% *real* growth, taking one year with another.

- The *energy* part of the business amounts to about $140 million today and we can see *real* growth by the early 80's running at probably 10% and better per year. An acquisition would be needed for stronger growth but this is a field that has already been heavily picked over for acquisition candidates.

• **Forest Products-AFPC**—We are now a $400 million company—about $200 million in sales through our distribution yards, and the rest through felling and converting timber, making particle board, molding and miscellaneous other products. By 1982 we will be a $600 million company because we can enjoy 3-4% *real* growth through upgrading product, normal expansion of distribution yards and, of course, inflation which runs higher for building materials than for other Bendix products.

• **Bendix Home Systems**—This is our first profitable year—only a token profit—since BHS was acquired in 1972. We see no sustained, significant profitability in the group unless fresh and chancy investments are made to take us into new versions of manufactured homes in rapidly growing populated areas and into down-sized recreational vehicles. There are better uses for our assets. Disposition is indicated but that means facing up to a loss of $20 million in goodwill. As this matter is still under study, we will defer further discussion of it.

• **Bendix International**—We look for a significant turn-around within the next 12 months. DBA, a major loser, will be neutralized and by 1980 should be a good contributor. The sale of Ducellier and Air Equipement [sic] will release assets from profitless businesses. Our other international operations are acceptably profitable and should show *real* growth of 5-6% per annum.

Summing up, we can look forward to roughly 5% *real* growth annually on sales, plus inflation of 6% for growth of about 10-11% on the average through 1982. Assumed increases in efficiencies—ROS's, investment turnovers, investment base management—would raise the ROI to 14-16%. Even allowing for inevitable optimism, sales are expected to exceed $5 billion in 1982 with PAT nearing $250 million. On the average, the increase in our net worth, leveraged with matching 50% in debt, gives us financing power for acquisitions of about $150-200 millions annually. Please see Annex A for indicative 1982 numbers for sales, earnings and cash flow.

III. STRATEGIES FOR GROWTH

If we are to find strong growth in the 80's, acquisitions must be made. As noted before, we have the financial means for doing so.

Acquisitions may prove very expensive. Corporate balance sheets are awash with cash and borrowing power; banks and insurance companies are eager to lend; and corporations seem more willing—as we are—to acquire than to build. Premium prices above market and book are being paid in acquisitions. McDermott acquired Babcock and Wilcox at 74% above book. Kennecott paid

89% above book for Carborundum. United Technologies paid 118% above for Ambac. There are many other cases to point to. In most cases, cash is the trading medium but securities have also been used. If we mean to acquire, timidity in facing up to premium prices and goodwill will mean defeat in our quest.

An acquisition can vary in scope. 100% control through merger or purchase; 51% control; or more than 20% but less than 50% which permits us to consolidate earnings on our books but nothing else. With anything under 20%, we would register only dividends received. Generally speaking, the dividends will recover our after-tax cost of capital. Our share of earnings should return more than our cost of money but there are circumstances where this might not be so.

With so much for background, let us now describe three basic thrusts we find attractive:

1. Greater Involvement in Basic Resources

- Equities in mining companies that are heavy in copper and that are grossly undervalued. We are not a Johnny-come-lately to this idea. Indeed, we may very well have held it even before Curtiss-Wright began high-tailing after Kennecott. We foresee a boom in copper prices in the 80's. The book value of present facilities is very much under replacement costs.

- Forest products, particularly timber, still look attractive. However, companies selling their trees demand an enormous premium over book; those companies are very expensive to acquire. By contrast, *shares* in large diversified fibre products companies—wood and paper—are selling at or near book and not far

from Bendix' P/E. Share prices do not reflect tree prices but seem more geared to earning power.

For mining and large forest products companies, the issue of *control* stands out. For example, to acquire all of, say, Champion International (forest products) at 50% above market price represents an outlay of over $1.5 billions while Phelps Dodge (mining) at a 50% premium would have a market value of about $750 millions. In either case, 20% of the equity is within our means. We shall return to this.

2. Enlarging the Industrial/Energy Group

We should renew our acquisition efforts in this area. The likelihood of finding available a company that is a direct supplier of oilfield well equipment or of coal mining equipment is not too great; the field has been well picked over. The possibilities are somewhat better of finding firms that serve to monitor manufacturing and refining processes with a view, among others, to conserving energy, materials and improving quality. A few companies that serve the power and processing industries as Babcock & Wilcox does are possible candidates.

In the broader industrial area, numerous candidates are worth consideration as we shall see later. Desirably, they should interact well with several of our present businesses.

3. Round-Out Acquisitions of Modest Size

- AFPC for more distribution yards and for additional vertical integration in molding, k.d. furniture, cabinets, other manufactured products. These are

businesses we know and we want to increase the value added in these sectors.

• Small to medium size high technology companies that fill gaps in our product lines in aerospace and industrial or automotive, or that protect a supply source or represent a suitable alternative to facilities expansion. This kind of acquisition would not be very costly as those in the first two categories hence we shall ignore them hereafter in this document.

IV. ACQUISITION TARGET—MINING

We have had an acquisition of a mining company in mind for sometime because we are bullish on basic resources for the balance of the century. Why so?

There is general acceptance in the industrialized world that the threat exists of a shortage in basic commodities for the balance of the century. Rising industrialization, increasing physical remoteness of accessible ores, and depletion of rich ore bodies, political instability in areas hitherto providing rich ores and large shares of world supply (e.g., Africa), capital costs for new processes to mine and refine lower grade ores, the lengthening periods for large, new projects (five to seven years), costs of environmental controls, threats of cartel-like actions by the Third World, the very large scale of new mining projects—these and others account for the preoccupation with resources. Europe and Japan are particularly concerned because of their commodity poverty. The U.S. is concerned, too, because we are increasingly dependent on imported commodities and we are concerned for the inflationary pressures—the ratchet effect in particular—that rising commodity prices would create.

It is indeed accepted lore that the world faces a commodity problem. The OECD, the United States government, the European community, the world financial community generally address the issue in terms of the need to assure supplies at non-inflationary prices. Granted, much the same has been heard in the past and the worst fears have not materialized but for the exceptional periods as in post-Korea and in 1973-74. Indeed, today's depressed prices for certain commodities such as zinc and copper tend to allay fears about prices for the 1980's. Still, we should heed those who have studied the subject. There is no want of studies or official opinion on the subject.

- Professor John Tilton of Penn State has written an excellent small work entitled, "The Future of Non-Fuel Minerals,"* addressed to the actions that might be taken to *prevent* serious shortages in the 1980's.

- Secretary Simon wrote to Robert McNamara, President of the World Bank, in 1976, the opening paragraph of his letter reading:

(Excerpted from letter dated September 30, 1976, to The Honorable Robert S. McNamara from William E. Simon, The Secretary of the Treasury.)

"Dear Bob:

As you know, we have felt for some time that a major international effort is needed to expand worldwide capacity in minerals if rising world needs are to be met.

---

* The Brookings Institution, 1977

The sensitivity of developing countries to private investment in their mineral deposits and the possibility of harrassment [sic] and expropriation of resource investments after such projects have matured are a deterrent to resource development in poor countries. We believe new forms of investment are needed to overcome the mutual reluctance of invesfors and host governments."

The Treasury's position remains unchanged. In international fora the U.S. is giving support to measures to encourage investments in resources, even going so far as to promise tangible support for buffer stocks and related arrangements to encourage reasonable price stability. This, it is said, will encourage investment, lead to lower unit costs, while benefiting producers and consumers alike.

The Council on Foreign Relations has a study group working now on the raw material problems of the 1980's. In attendance are heads of major U.S. and foreign mining companies and, by a curious quirk, an officer of The Bendix Corporation. It is the common theme of the working sessions that a problem of the 1980's is the probable lack of investment in mining projects overseas because of uncertainties in many developing countries. It is indeed noted that investments are being increasingly directed towards more stable areas such as Canada and Australia. But recently depressed conditions have deterred such investments hence the common belief in the Council sessions that shortages will develop in the 1980's. In any case, the shift towards more stable areas may also mean higher costs because, generally speaking, ore grades are less rich there.

Our interests have run particularly to copper. It is one of the most widely used industrial commodities and has been in a depressed state for several years. So have the equities of leading copper companies. Further, several such companies produce other important raw materials along with their copper mining and refining. There are other important reasons which portend a good future in copper in the 1980's.

- Investments in new copper mining, smelting, and refining facilities have lagged because of depressed markets and unfavorable political and economic conditions in the Third World where much of the richest copper ores are to be found. Hence, there is the threat of capacity shortages in the 1980's, driving prices upwards.

- Technological threats to copper appear to have reached their limits. Displacement has already occurred by aluminum and there are limits as to displacement by optic fibers.

- New capacity is horribly expensive to organize. Existing facilities such as those of Kennecott or ASARCO cost about $3,000 per ton of annual capacity while a green grass project costs over $8,000 per ton, rising by 8% or more per year. Those who have low-cost installed capacity have an enormous advantage over newcomers. It is said that no project would be started today unless copper prices averaging well over $1.00 per pound *in 1975* prices were foreseen for the mid-1980's—the length of time to bring a project into being. By contrast, the large American companies with stateside production are believed to break-even today at prices at around 70¢ per pound on the average and, while variable costs will rise, the bulk of these costs are in a low price capacity in place.

There are reasons to be cautious about copper. Years ago, orderly production, marketing, and controller pricing in the interest of stable markets and profit maximization were assured as 75% or more of production was in the hands of seven or eight firms, mostly U.S. owned. Their control has fallen. Today, about 50% of world capacity is in the hands of so-called weak sellers—governments of developing countries, heavily dependent upon mineral exports for foreign exchange earnings. So long as export prices cover at least the foreign exchange costs of producing for export, they will do so. No matter their failure to recapture capital costs, leave alone to earn a return to finance further expansion. The governments, major employers in the mines, will keep them going virtually under any conditions. Foolhardy as this is recognized to be, inter-governmental efforts to agree on production or export quotas have failed. Of course, these governments are *not* accruing the capital required for new capacity to replace aging, depleted mines and smelters.

The upturn in copper prices awaits some combination of stronger demand—worldwide recovery, more orderly international marketing, and a reduction of heavy stockpiles that refuse to drop because of continued high production. Some evidence of stronger demand is becoming evident.

The gamble is on when the turn will come—as it will. A big run-up in prices before the early 1980's cannot be expected, in part because substantial new capacity is coming in by then. But thereafter little capacity can be added because too few projects are in the works. In past recoveries from recessions, stockpiles have fallen quickly as supplies move from producer to consumer. And there is pressure in a number of countries for governmental

action to build up strategic and economic stockpiles partly to relieve the depressed market. Intergovernmental actions along the lines of a buffer stock is [sic] also a possibility but are not to be reckoned upon.

It is important in this area of commodities to remove oneself from rapt attention to short-term movements. Prices can shift drastically in short periods and the euphoria of this moment can change to dismay soon thereafter. It is the long-term perspective that should guide us so long as we are sure that the near-term effects are not unduly harmful. For learned opinions of the future for basic commodities—copper included—in the 1980's, please see Annex B.

Qualifying the Candidate

In looking for an acquisition candidate, one would seek a firm having these qualities among others:

1. Capable management.

2. Undervalued assets—a stock market price well under book value and assets in good condition that could not be replaced at several times their book cost.

3. Product diversification. Copper is a leading mineral but there are others that also promise strong futures.

4. Good balance between mining, smelting, and refining capacity.

5. Geographic diversification to serve world markets and to avoid undue dependence on

any one area. For example, Latin American production generally serves Europe and Japan while U.S. production almost wholly serves this market.

6. A record of ability to organize, navigate, and survive in the volatile Third World—if much of its assets are there.

7. Participation in projects whose evident potentials are yet to be realized and whose assets values do not appear on the books.

8. A respectable balance sheet, one that suggests adequate cash flow for debt service and necessary capital outlays notwithstanding stinted profits.

9. Costs of environmental controls that are reasonably manageable and substantially already covered.

Orange Crush is a firm we considered. It lacked many of the foregoing qualities but it possessed enormous amounts of cash as a result of a disposition. Subsequently, it bought a major U.S. company for cash costing nearly $600 million at a premium of about 90% above book. We became convinced that a play would be made for the firm to realize on its underutilized assets.

Blackie is a firm which nearly matches the qualities we seek. The Annual Report for 1977 makes for easy reading and provides much the kind of data to be found in a 10K. Particular attention should be paid to Blackie's product diversification particularly in silver, zinc, asbestos, lead, coal and other profitable minerals and to its rich holdings

in the M.I.M. Holdings (Mt. Isa project) in Australia reported to be one of the largest mining operations in the world. Allegedly, Blackie's holdings in this project at market value exceed the market value of Blackie's own equities. While it is not possible to establish that this is so, no doubt they do have value considerably in excess of that on Blackie's books.

Attention should also be given to Blackie's other equity holdings which generate attractive although cyclical dividends, e.g., its minority holdings in Revere Copper & Brass of 33%.

Further attention should be given to Blackie's seemingly comfortable position in the area of pollution control.

Some key data on Blackie reflecting the volatility of its markets—are:

	1974	1975	1976	1977
EPS	$4.66	$.95	$1.58	($1.10)
Stock Price—High-Low				23-5/8 /$13
Book Value Per Share				$30.28
No. Shares Outstanding				- 26.7M

After consultation with a limited number of Directors and general advice as to our intentions with others, we began in January to purchase shares of both Orange Crush and Blackie.

Our intentions were not to speculate in the market but rather to give us a head start in the event we decided to move towards an equity position or [sic] control. As of March 30 we have acquired 231,500 shares of Orange Crush at an average price of $22.68 while the closing price on March 29 was $25 7/8. This represents just .7% of outstanding shares. In the same period, another firm acquired 9.9% of the firm and has indicated its intention to seek a slate of Directors who will realize for shareholders the underlying value that it claims has been mishandled by present management. A proxy fight to elect a slate of Directors is underway.

We have no reason to believe tht [sic] Blackie is the object of an attack by any party though there has been a sudden rise in share volume and price in recent days.

Clearly, there is evident interest in resources by many companies: ARCO which bought Anaconda; Standard of California's purchase of a 20% equity investment in AMAX; Exxon which just paid over $100 million for a Chilean copper mine; and Curtiss-Wright's pursuit of Kennecott mirror this interest. Wall Street commodity analysts are speculating over whether mining companies are take-over targets because of market values well under book values.

We have debated whether we should seek total ownership of Blackie, simple majority, or 20% in order to consolidate earnings. Book value is over $30 per share. Market value is about $20 per share. We own 1,130,000

shares or 4.2% of the total at an average price of $16 per share. Assuming that we wound up paying $25 cash per share for its 27 million outstanding shares, total cost would be about $675 million, which would require a major pre-financing arrangement. A simple majority would imply about $340 million cash which we could probably manage although we would then want to contemplate further steps to tender for the remaining 49%. Quite obviously, a 20% position imposes a much smaller burden on us, manageable with our present resources and implying a lower cost per share than entailed in a much larger position.

We favor the 20% position and not just because of our ability to manage this with our present financial structure. Rather, we want time to become more familiar with the company and the industry before chancing a significantly larger position. Further, we do not want excessive exposure to the cyclicality of Blackie's earnings. These earnings should rise in the next few years but what goes up will in due course come down. What's more, we want to leave ourselves the financial mobility to undertake one or the other or both of the forest products and industrial acquisitions hitherto mentioned. Blackie (20%) and one other can probably be done within the year but acquiring 100% of Blackie would probably interfere with any other near-term sizeable acquisitions.

On the matter of control. It does not follow that our influence in the company is only nominal because we would lack 51%. If we were to enjoy a good relationship with Blackie—with a seat or two on the Board—our influence could be felt. Much would depend, of course, on whether Blackie resisted or accepted our presence—about which more is said later. Even if it initially resisted,

in due course it could come around to accept if not welcome our presence and advice.

Particular attention should be given to profit prospects for the near-term. It is not clear that Blackie will be profitable in 1978 or, for that matter, in 1979. In 1977 it showed a $30 million loss in part because of unusual write-offs, strikes and other reasons. A dividend of 70¢ was paid in 1977 which was well under the dividend paid in 1974 of $1.43, reflecting profit volatility. The indicated dividend for 1978 is 40¢ per share. Thus for our 20% we might get the worst of two cases: Our 20% share of any loss and very small cash flow because of reduced dividends. Offsetting the loss would be the amortization of the negative goodwill of $5.00 per share (book value less share value).

This is, of course, the blackest picture. One could equally well forecast profit recovery in 1978, certainly by 1979. The impact of various assumptions as to Blackie's earnings on our EPS appear on the following page.

As to cash flow, it appears that Blackie's amortization and minority earnings in other enterprises are more than sufficient to cover debt service and capital outlays in the near-term, so we believe.

	Blackie's Earnings $ Million	Blackie's Assumed Earnings $ Million			Impact on Bendix Earnings of ABC		
		A	B	C	A	B	C
1973	99.4						
1974	124.6						
1975	25.4						
1976	42.3						
1977	(29.5)*						
1978		–	–	25	–	–	$.22
1979		50	25	75	$.44	$.22	$.66
1980		100	50	125	$.88	$.44	$1.12

*Includes $39 million of unusual charges for plant and mine operations shutdown.

We must anticipate that Blackie will be hostile to our assuming a 20% position. It knows that we already have a modest position and has indicated that it would like it to stay modest. In informal conversations—in no manner of speaking can one describe these as negotiations or as providing insider information—Blackie management has been very cordial to Bendix and has said that its investment should prove to be a wise one.

If we decide to proceed beyond 5%, an SEC Schedule 13D must be filed within 10 days after passing beyond 5%. Perhaps another 5% could be acquired in those ten days—just a judgment—at rising prices. Once our hand were shown—that it was our intention to go to 20%—the share price would rise even more—unless Blackie took action through State and Federal courts,

through the SEC and otherwise to delay and thwart any further purchase by us.

To state this differently, we must anticipate a fight from Blackie even though we were to declare our intentions to remain as an entirely passive shareholder. It is possible that Blackie will be friendly to us, considering that it might be attacked by a less congenial party.

It is also possible that others interested in Blackie would enter the fray. Possibly, a tender to acquire a larger position than ours or to thwart our efforts would be made by another group. If the bidding became too severe causing excessive price rises, we would have to regroup: settle for less than 20%; liquidate our holdings or plunge on. We do not want to pay an average price that approaches book value of $30. A nominal price of $25 allows for a substantial share of the acquisition of 20% at well under $25, the remainder at or above it. Only an immediate tender by someone else at well over book value should bar us from acquiring 20% at significantly less than book value. Negative goodwill would accompany our 20%. At $25 per share, 20% would cost $135 million.

In connection with the 13D, we would have to face the issue of stating our intentions regarding nominating Directors on Blackie's Board. This is a matter we would like to discuss with our Board members.

Assuming success, what would happen next? We would organize ourselves to form a shadow group here to learn as much as we can about the company and the industry. If our nominees entered Blackie's Board, we would gain access to insider information which could inhibit but not bar further acquisition of shares. Within a

time that cannot now be defined, we would decide on whether to enlarge or sell our holdings and, if so, how to do so. It is our intention not to let the matter dawdle.

Finally, one note on the reaction in financial circles to our acquiring 20% of Blackie. Probably, on the whole it will be somewhat negative:

- It is not a business Bendix knows.
- We will have no management control.
- Earnings are clouded for the near-term.

But it is quite possible that reaction will be quite different:

- We are buying an undervalued asset for the 1980's.
- We are not tying up our management. It is free to concentrate on matters it knows best.
- Bendix is an interesting company—moving into areas beyond its traditional activities.

If the reaction is negative—and Wall Street experts are divided on this—we must anticipate some reaction on our stock price, or lagging growth in our price if the general market moves up. If that happened, of course, other acquisitions would become somehwat [sic] more difficult for us to make.

At this point two questions should stand out:

1. Why Blackie?

2. Why now?

In fact, these two questions come together. It is true that we have not considered other mining companies but for Orange Crush and even that was barely done. But the action on Orange Crush has generated in some measure a sympathetic reaction on Blackie's stock price. It is now 20 and was 13 within the past two months. Our activity accounts only in part for the rise for the market has moved up even when we have been absent from it.

Had we waited for a thorough study of all candidates for our entry into mining, we would have been greatly delayed and it was our judgment that delay was harmful to achieving our purpose. In any case, our brief review of the company and the industry and the exposure we have had with members of the mining industry leave us feeling comfortable with selection of Blackie. We are, after all, so well reminded of conflicting adages: Look before you leap. He who hesitates is lost.

V. FOREST PRODUCTS

AFPC supplies from its own timber only about 20% of what it converts or remanufactures. We live off of forest service timber for almost all of our remaining conversion needs and that supply is increasingly scarce and heavily bid for. Tree prices have gone wild in recent years. Since we acquired AFPC in 1970, our tree values have increased from 15-25% per annum, depending on species.

There are no timber holdings near AFPC's sawmills that it makes economic sense to buy. Looking elsewhere in the Northwest, there are three companies, each smaller than AFPC, that we believe might be

available. If bought at a proper price, we would spread our geography and have rising timber values in the 1980's. Of course, the sellers know that and have set a present value on the timber that recognizes the anticipated gains in the 1980's.

The three properties are:

	Estimated Acquisition Price $ Millions	Sales (1977) $ Millions
Brooks-Scanlon	90-100	74
Pope & Talbot	80-85	119
Medford	75-80	106
AFPC		411 (1978)

Annex D shows their timber holdings and other facilities. They are all much lighter in conversion and distribution than AFPC and two of them have less timber acreage than AFPC. Studies now underway will indicate the price we can afford to pay without excessive dilution or without punishing the D/E. We must expect to pay at least 75-100% above book value because timber holdings, the main asset, are booked at nominal values. For example, Brooks-Scanlon carry their 242,000 acres of trees on their books at $7.2 million while at anything like a bargain price for a reasonable mix of species and height and quality that acreage should sell for at least $500 per acre, quite possibly much more. AFPC's 170,000 acres and roads are carried on our books at $31 million but we reckon our acreage—with our rich species—to be worth

at least $1,000 per acre and we would probably reject an offer at that price.

The (pro forma 1977) impacts upon Bendix EPS and debt ratio of these transactions are:

	Brooks-Scanlon*	Medford**	Pope & Talbot**
Δ Impact on EPS			
All Cash	+ .18	+ .04	+ .04
65 Stock/35 Cash	- .08	- .10	- .21
Pooling	- .19	- .30	- .42
Δ Debt/Equity			
All Cash	+ 5 points	1 point	- 1 point
65/35	+ 1 point	-	+ 2 points
Pooling	- 1 point	4 points	+ 8 points

* Brooks at asking price

** Medford and Pope and Talbot at 75-100% above book value.

The earnings of these companies are modest in relation to acquisition prices; they cannot be bought on the basis of customary P/E's in the 6-10 range. We must buy them based on *future* earnings built around the appreciation in the value of trees. We must also anticipate some near-term capital outlays to improve facilities and to increase conversion capacity. Studies are not yet complete on these matters; the numbers used are only directional purposes.

An acquisition for stock is dilutive in all cases and we would prefer a cash or stock/cash transaction. Moreover, we cannot reckon on a rapid growth in earnings inasmuch as we do not want to sell logs, and conversion and distribution facilities are limited—time and investments being necessary to build them up. Some spin-off benefits to AFPC would be realized. But we should understand that anyone of these purchases is for growth in the 1980's—in a cyclical business—and not for the near term.

All of these companies have significant blocks of shares in limited hands. It is possible to probable that stock transactions will be insisted upon for tax reasons. However, we are confident that if we strongly want one of these companies, we can arrange it. We should also note that a stock transaction could place a sizeable amount of Bendix stock in a limited number of hands. With Brooks-Scanlon as an example, a $100 million transaction would result in 3,000,000 shares of Bendix stock being issued and we have reason to believe that at least half of that would be held by two families. That would then represent about a bit under one-eighth Bendix shares outstanding.

The alternative is, as we said before, to take over one of the larger forest product companies. The sheer size of these companies makes such a takeover unreachable. These are illustrations:

	Investment Base $ Billions
Champion	2.0
Crown Zellerbach	1.4
McMillan Bloedel	1.0

Even 51% is an enormous stretch for us. But 20% is within reach. In this case, we would be more inclined to remain an equity holder than to seek management control. Conceivably, a merger of companies would not be ruled out as with Montgomery Ward and Container Corporation years back.

A 20% portion—and assuming that we have to pay 50% over market value—gives us these directional numbers:

	EPS Pro Forma Impact 1977	D/E
Champion	+ .50	+ 15
Crown Zellerbach	+ .39	+ 13
McMillan Bloedel	- .06	+ .9

Again, the cash transaction improves our EPS but worsens the D/E.

Here, again, we might well face the same kinds of issues raised in connection with Blackie: resistance by present management—possibly a fight; the premium to

be paid, particularly since we do not see the same kicker for the 1980's as for Blackie. But we do see greater near-term assurance of income than Blackie can provide.

Our inclination favors the smaller acquisition which we would control wholly but there is no doubt that there is greater underlying value and near-term benefit in a 20% position in a successful major forest products company than is to be gotten from one of the smaller ones.

The Board's view on the choice between these two ways of enlarging our position in the forest products area would be welcome to us.

VI. INDUSTRIAL ENERGY

In the industrial energy area we have, broadly speaking, three directions in which to go: acquire a company broadly described as industrial; select a company focused on one specific sector of industry, generally outside of our present businesses; or choose a company which particularly related to one of our business groups. Let us illustrate by referring you to Annex C, a list of 21 companies that have received our close attention. But here we will mention just four companies to make our point:

> Foxboro—concentrated on process control equipment, generally outside of our businesses.
>
> Cutler-Hammer—electrical and process control equipment, one-fourth of its business directly related to aerospace activities.

Clark Equipment—an industrial conglomerate that makes motive power transmission equipment, construction equipment, forklifts and materials handling equipment, and other products.

Foster Wheeler—design and erection of power and processing plants.

Other things equal, we prefer companies whose businesses closely complement ours—but that will not raise anti-trust problems. We have reviewed several hundred companies, well over eighty of them in some detail. Twenty to twenty-five repeatedly capture our attention, most being on the annexed list just referred to. We cannot expect to acquire any of these companies at less than 30% premium above market and 50% or above is more likely. But just to illustrate the impact of acquisitions at a nominal premium price—30%—let's look at seven companies on the following page.

In all cases a cash transaction will carry our debt ratio well beyond the 65/35 limit. A stock transaction is to be preferred only that causes a dilution of some consequence. A combination stock/cash transaction represents a happy compromise and that will be one of our objectives in any transaction. Preferred stock would be used where possible. Where dilution is evident we will give particular attention to the profit growth of the acquired company so as to foresee when dilution may be ended.

So as not to minimize the problem—dilution or debt ratio—let us note again that heavy premiums are now being paid—30% will never do—and goodwill accompanies a cash transaction.

PRO FORMA IMPACT ON BENDIX
1977

	Foster Wheeler	Gardner Denver	Hyster	Amer. Hoist & Derrick	Foxboro	Cutler-Hammer	Clark Equip.
ΔEPS							
Cash	+.57	.11	1.18	.44	.74	.53	1.49
Pooling	-.32	-1.18	.07	-.21	-.52	-.45	-.74
D/E							
Stock	+.1	+.1	–	+.3	-.2	+.4	.3
Cash	+.15	+.25	+.15	+.13	+.17	+.20	+.30

Based on 30% premium above market price at various recent dates.

Also bidding contests are frequent so a friendly take-over is to be preferred to a fight-out. But in any move we make, a fight may be anticipated. To thwart it, we may have to offer all cash or pay a very high premium if we offer both stock and cash, or stock alone.

Conversations through intermediaries are underway with several of the companies to determine the interests in a friendly acquisition. If that cannot be arranged, we may decide to tender for one or another of these firms, but would, of course, return to the Board for authorization to do so.

/s/W.M. Agee

JJ
Attachments

ANNEXES

TABLE OF CONTENTS

ANNEX A: 1978-82 Long Range Plan
Consolidated Bendix with Acquisition Assumptions

ANNEX B: Excerpts from the following documents:

1. Price Prospects for Major Primary Commodities
   Source: Document of the World Bank—June 1977

2. The United Nations Panel on International Mining Finance (background paper number 1)—October 1977

3. Minerals and Energy in the Developing Countries
   Source: Document of the World Bank—May 1977

4. A privileged-private study prepared by Charles River Associates

5. An in-house study by a major U.S. mining company.

ANNEX C: 21 Company Comparisons

ANNEX D: Wood Products Companies—Facilities

(Annexes B, C and D omitted in printing)

1978-1982 LONG RANGE PLAN
CONSOLIDATED BENDIX WITH ACQUISITION ASSUMPTIONS
($ in Millions Except Per Share Values)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Total Plan											
Sales	$1,763	$2,212	$2,464	$2,590	$2,947	$3,269	$3,477	$3,847	$4,318	$4,817	$5,25
PBT	117	132	148	135	192	219	252	284	342	413	473
EPS ($)	2.53	3.14	3.48	3.66	4.74	5.27	5.89	6.57	7.93	9.57	10.81
Dividends/Shr. ($)	1.20	1.20	1.31	1.39	1.66	2.00	2.36	2.63	3.17	3.83	4.32
Net income	56	69	76	80	105	118	133	150	183	222	254
Investment T/O (x)	1.8x	2.2x	2.2x	2.2x	2.6x	2.8x	2.8x	2.8x	2.9x	3.0x	3.0x
ROI (%)	7.6%	9.1%	9.8%	9.5%	11.4%	12.4%	12.6%	13.1%	14.4%	15.6%	16.1%
ROS (%)	6.3%	5.9%	6.0%	5.2%	6.5%	6.7%	7.3%	7.4%	7.9%	8.6%	9.0%
Year-End Debt Ratio (%)	31.5%	35.7%	36.0%	33.2%	29.7%	28.0%	26.1%	25.0%	23.5%	20.7%	17.0%
Year-End Surplus Borrowing Power Assuming Target Debt Ratio of 35%						$ 129	$ 177	$ 218	$ 274	$ 370	$ 501

EXHIBIT D-18 TO THE TRANSCRIPT OF THE DEPOSITION OF WILLIAM AGEE DATED AUGUST 21, 1986 (Excerpt from the Records of the Meeting of the Board of Directors of The Bendix Corporation Held April 13, 1978, omitted in printing)*

Office of
The Chairman and President

Bendix

Date April 12, 1978

To Board of Directors

From W. M. Agee

Subject Acquisition of Shares of ASARCO

The Board's consent is asked for the cash acquisition of up to 20% of the common shares of ASARCO at a cost not to exceed $134 million. Of this amount, we already own 4.9% at a cost of approximately $22 million. We would pay ASARCO up to $92 million for 12% of the shares and would expect to pay an estimated $20 million in the open market for an additional 3% of the shares:

Recapitulation

Presently owned	4.9%	$22 million
12% to ASARCO	12.0%	$92 million
Further Aftermarket Purchase	3.1%	$20 million
	20.0%	$134 million

This acquisition clearly will aid us in our acquisition strategies whose purposes are:

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* The documents included in Exhibit D-18 were attached to the Stipulation of Facts (J.A. 152–198) in this case as "Exhibit F." (*See* J.A. 196). The memorandum dated April 12, 1978, from W.M. Agee to the Board of Directors of The Bendix Corporation included in Exhibit D-18 is cited in the Brief of Petitioner as "Exhibit F."

- Reducing our dependence on the relatively slow-growing aerospace and automotive OEM market.

- Broadening our Industrial/Energy Group to give it size and better definition.

- Generating good cash flow in the early 1980's to meet growing capital needs, particularly in aerospace/electronics to permit it to hold its own in stiffening markets.

- Broadening our holding in basic commodities, particularly forest products and in non-fuel minerals that should prosper from the energy problem or which have other reasons for strong market position in the 1980's.

ASARCO clearly meets the last objective. We have actively in mind acquisitions in the forest products and industrial areas which we hope to bring to the Board in the not too distant future.

BACKGROUND ON ASARCO

ASARCO is engaged in copper mining and production in the U.S. and abroad, principally in Latin America. It is also a significant producer of lead, zinc, silver, asbestos, coal and other lesser minerals. ASARCO also has important equity holdings in Australia, Mexico, Nicaragua, Canada and elsewhere which make significant contributions to earnings. It is a leading smelter and refiner of metals for its own account and under toll arrangements.

ASARCO's Primary Metal Production in 1977
(in thousands)

Copper	$214,230
Silver	185,864
Lead	100,113
Zinc	53,006
Other	180,080
	$733,293

ASARCO's other major sales come from coal and asbestos.

In the last five years, ASARCO's sales have ranged from $1,004 million to $1,344 million. Last year was near its low—$1,046 million—caused by extended strikes and depressed market conditions for copper and zinc.

Silver and lead enjoyed good years as did asbestos. ASARCO's earnings are highly volatile, reflecting the volatility of its markets, viz:

	$ Millions	Per Share
1973	99.4	$3.72
1974	124.6*	4.66
1975	25.4*	.95
1976	42.3	1.58
1977	(29.5)*	(1.10)

***Unusual Items**

1974	(39.8)
1975	(20.5)
1977	(39.0)

Our Interest in Commodities

There is general acceptance in the industrialized world that the threat exists of a shortage in basic commodities for the balance of the century. Rising industrialization, increasing physical remoteness of accessible ores, and depletion of rich ore bodies, political instability in areas hitherto providing rich ores and large shares of world supply (e.g., Africa), capital costs for new processes to mine and refine lower grade ores, the lengthening periods for large, new projects (five to seven years), costs of environmental controls, threats of cartel-like actions by the Third World, the very large scale of new mining projects—these and others account for the preoccupation with resources. Europe and Japan are particularly concerned because of their commodity poverty. The U.S. is concerned, too, because we are increasingly dependent on imported commodities and we are concerned for the inflationary pressures that rising commodity prices would create.

THE OECD, the United States government, the European community, the world financial community generally address the issue in terms of the need to assure supplies at non-inflationary prices.

The World Bank has stepped up its program for lending to developing countries for basic resource development. Regional banks such as the Inter-American Development Bank are doing the same. Secretaries Simon and

Blumenthal have expressed their concerns for the lack of investments in resources for the 1980's. And the U.S. is lending support to the principle of buffer stocks to foster stability in prices and demand as an aid to assured supply.

COPPER

Since copper is the core of ASARCO's business, our attention in this paper is principally on that metal: It is a widely used industrial commodity, subject to wide fluctuations in price and less wide fluctuations in demand and supply.

About 60% of the free world's supply comes from outside the U.S. Demand rises steadily but price moves erratically as stocks change and as recession, boom, political developments, currency movements, and other factors influence markets. For the past several years over-supply has prevailed in part because of the worldwide recession but also as the developing countries, now controlling over half of the free world's supply, continue to press production in the face of slow growth in the market. Stocks are now unduly large.

Prevailing opinion in governmental circles, in industrial, and in financial circles holds that copper may remain depressed for another year or two. But by the early 1980's, forecasts hold that it will be a boom commodity. Among these reasons are:

- Investments in new copper mining, smelting, and refining facilities have lagged because of depressed markets and unfavorable political and economic conditions in the Third World where much of the richest copper ores are to be

found. Hence, there is the threat of capacity shortages in the 1980's, driving prices upwards. A shortage of smelting capacity is of particular concern but, fortunately for ASARCO, it is well fixed.

- Technological threats to copper appear to have reached their limits. Displacement has already occurred by aluminum and there are limits to displacement by optic fibers.

- New capacity is horribly expensive to organize. Existing facilities such as those of Kennecott or ASARCO cost about $3,000 per ton of annual capacity while a green grass project costs over $8,000 per ton, rising by 8% or more per year. Those who have low-cost installed capacity have an enormous advantage over newcomers. It is said that no project would be started today unless copper prices averaging well over $1.00 per pound *in 1975* prices were foreseen for the mid-1980's—the length of time to bring a project into being. By contrast, the large American companies with stateside production are believed to break-even today at prices at around 70¢ per pound on the average and, while variable costs will rise, the bulk of these costs are in low price capacity in place.

- Electrification is likely to grow as electrical energy supplants other forms of energy, development proceeds in the emerging Third World, solar energy grows in importance, desalination plants rise in importance, new construction sees copper displacing aluminum, which had earlier displaced it, and as copper

displaces aluminum in other areas where thermal/electrical efficiency is of paramount importance.

The upturn in copper prices awaits some combination of stronger demand—worldwide recovery, more orderly international marketing, and a reduction of heavy stockpiles that refuse to drop because of continued high production overseas. Some evidence of stronger demand is becoming evident.

A big run-up in prices before the early 1980's cannot be expected, in part because substantial new capacity is coming in by then. But thereafter little capacity can be added because too few projects are in the works. In past recoveries from recessions, stockpiles have fallen quickly as supplies move from producer to consumer. And there is pressure in a number of countries for governmental action to build up strategic and economic stockpiles partly to relieve the depressed market.

ASARCO's Attributes

1. Capable management.

2. Undervalued assets—a stock market price well under book value and assets in good condition that could not be replaced at several times their book cost.

3. Product diversification. Copper is a leading mineral but there are others that also promise strong futures—silver, asbestos, coal.

4. Good balance between mining, smelting, and refining capacity.

5. Geographic diversification to serve world markets and to avoid undue dependence on any one area. For example, Latin American production generally serves Europe and Japan while U.S. production almost wholly serves this market.

6. A record of ability to organize, navigate, and survive in the volatile Third World—and much of its assets are there.

7. Participation in projects whose evident potentials are yet to be realized and whose assets values do not appear on the books.

8. A respectable balance sheet, one that suggests adequate cash flow for debt service and necessary capital outlays notwithstanding stinted profits.

9. Costs of environmental controls that are reasonably manageable and substantially already covered.

Particular attention should be paid to ASARCO's product diversification, particularly in silver, zinc, asbestos, lead, coal and other profitable minerals and to its rich holdings in the M.I.M. Holdings (Mt. Isa project) in Australia, reported to be one of the largest mining operations in the world. Allegedly, ASARCO's holdings in this project at market value exceed the market value of ASARCO's own equities. While it is not possible to establish that this is so, no doubt they do have value considerably in excess of that on ASARCO's books.

Note should also be taken of ASARCO's other equity holdings which generate attractive, although cyclical dividends, e.g., its minority holdings in Revere Copper and Brass of 33%.

Further attention should be given to ASARCO's seemingly comfortable position in the area of pollution control. It reports that its facilities are in good condition and it is believed that it had already met relatively more of its outlays for pollution control than is so for the industry generally.

Appropriate Cautions

An acquisition in ASARCO involves several departures for us.

First, it would put us into base and precious metals, and other minerals—in which we are not now involved. This departure should not concern us since we are confident of markets for the 1980's and have negotiated a good price for ASARCO's stock. Its management is also well regarded. A consultant known to several Board members—Mr. Robert Koenig [sic]—formerly President of Cerro de Pasco, has known ASARCO and other mining companies for many years and is intimately familiar with ASARCO's holdings in Peru and elsewhere. Mr. Keonig [sic] gives good marks to ASARCO's management. He has endorsed this arrangement, having been advised of it under an oath of secrecy.

Second, we would not acquire the controlling interest in the company, but rather would be a minority holder of 17% of the shares with the intention in due course to increase our holdings to 20%. We favor this position essentially for two reasons: One is to avoid an undue

share of Bendix' assets going into a new business. And, second, we want to avoid excessive exposure to the cyclicality of ASARCO's earnings.

It does not follow that minority ownership means lack of influence. With two seats on the Board, our voice will be heard. With friendly relations, our insights and judgments will be recognized. Our shareholdings always make us a force to be reckoned with. As one person has been heard to say, "When the Directors representing Standard of California (SOCAL)—owner of 20% of AMAX—speak, they are listened to."

We have to assume that the Directors of Cutler-Hammer will also listen to Koppers, which in a friendly arrangement, is to acquire 20% of Cutler-Hammer.

The Nature of the Transaction

Late last year we became persuaded of the desirability of entering the mining industry. Two companies, Kennecott and ASARCO, struck us as obvious candidates. Kennecott was rich in assets but poor in operations. ASARCO was known to view the future with cautious optimism and on several informal occasions had made known its high regard for Bendix.

After consultation with various members of the Board, we began to purchase the shares of both companies in order to position ourselves to proceed with either and to do so while the shares were way undervalued. After accumulating 231,500 shares of Kennecott at an average price of $22.57, we ceased our purchases. We had decided that Kennecott was not our entry. Moreover, others had entered the bidding fray. The stock closed on April 10 at $26.62.

We proceeded with ASARCO, accumulating 1,300,000 shares or roughly 4.9% at an average price of $16.50, while the stock closed on April 10 at $19.87.

Meanwhile, we had informed ASARCO of our intentions to accumulate and of our friendly intentions. The market roiled over this period, sparked in part by the Curtiss-Wright assault on Kennecott; traders and arbitrageurs looking for a bidding contest; other parties having in mind a takeover; sheer speculators; and of course, our purchases. In the past several months, prices have ranged from $13 to just over $20.

Deciding that a 20% position was desirable, we met with the Long Range Planning Committee of the Board to describe our intentions. We stated that ASARCO might favor our entry through a private placement—either a convertible preferred or common shares. The Committee endorsed the idea, following which in conversations with ASARCO, it became clear that it favored our entry, but not through a convertible preferred.

The following terms were agreed [sic] subject to Board approval:

Terms of the Arrangement with ASARCO

1. Bendix will purchase 4 million shares from ASARCO at the price of $23 per share for a total value of $92 million. Together with the 1,300,000 shares purchased by us in the open market at a value of $16.50 per share, we will have an investment of $114 million in ASARCO, representing 5,300,000 shares of 17% of the total common outstanding.

2. For a period of years, Bendix agrees not to own more than 21% of the outstanding common shares of ASARCO.

3. Bendix will hold two seats on the Board of Directors of ASARCO. Mr. Agee and one other person to be designated would represent Bendix.

4. ASARCO will have the right of first refusal in the event that Bendix intends to dispose of its share holdings in the amount of 1 million or more shares.

It is our intention sometime in the reasonably near future to increase our holdings from 17% to over 20%, but not more than 21%, of the ASARCO shares outstanding. For our planning purposes, we assume that such shares can be purchased in the open market at an average price of $23 per share. The cost of this 3%, representing 850,000 shares, would be $20 million. When added to the $92 million to be paid ASARCO and the 4.9% already owned, our total investment would rise from $114 million to $134 million.

A definitive contract would be signed immediately upon approval of the respective Boards. The ASARCO Board is expected to approve the arrangement by April 14.

Financial Outlook

As earlier noted, under present accounting rules, we would follow the "historical accounting" method until we reach the 20% ownership level, absent management agreements or other evidence of our ability to influence the management of ASARCO. Under the "historical" rules, we would carry our investment on the balance

sheet at our cost and reflect only the dividends received from ASARCO in income. At the present $.40 rate, the dividends would fall short of the debt service under the 100% debt assumption by $2.7 million. A return by ASARCO to the $.80 dividend rate paid in early 1977, would offset the majority of this shortfall.

With a 20% ownership, we, in all probability, would begin to account for our investment under the so-called equity method. Under this method, Bendix income reflects its share of the income of ASARCO and also amortizes so-called "negative goodwill" of about $2 million per year. Under the 100% debt financing assumption, earnings per share would be diluted about 9¢ per share if ASARCO were to break even on an operating basis, and would be enhanced by about 33¢ if ASARCO were to earn around $50 million. We break even from an earnings per share standpoint if ASARCO earns around $15 million of after tax earnings, which it has exceeded in four of the last five years.

As we have discussed at various times in the past, our overriding financial objectives in considering any acquisition are the maintenance of our debt ratio in the 35% range and, at the same time, leave ourselves with reasonable flexibility for the future.

Since the 100% debt assumption indicates a debt ratio in the upper limits of our 35% target range, we have included a couple of additional sets of calculations, one assuming $50 million if cash were freed upon from divestment of existing operations and the other assuming a $70 million issuance of preferred stock.

The $50 million divestment alternative clearly indicates the attractiveness on earnings, cash flow, and debt ratio

of reallocating some of our resources through liquidation or divestments. We have selected $50 million in divestments as only representative and clearly within our reach. This is particularly true if the Ducellier transaction is finalized, since it alone represents over half of the target amount. Other candidates presently under study would generate the balance or more.

Another way to assure our staying within the 65/35 debt ratio is through the issuance of preferred shares. The attached schedule shows the significant dilution of earnings of an 8-1/2% dividend coupon as compared with the 100% debt alternative. On the other hand, compared to other means of equity financing, preferred stock does lock in equity at a constant cost. Of course, the rising earnings of ASARCO are expected to provide increasing income contributions over time.

While the attachments include preferred stock financing as a back-up alternative to a divestment program, it is our present strategy that the divestment program be pursued vigorously and that the preferred stock or other equity financing be reserved for future transactions.

While we would utilize short-term bridge loans to provide initial financing for this transaction, we would expect to arrange suitable long-term debt or equity financing in the future.

(Attached schedules omitted in printing)

EXHIBIT D-19 TO THE TRANSCRIPT OF THE DEPOSITION OF WILLIAM AGEE DATED AUGUST 21, 1986

1ST STORY of Level 1 printed in FULL format.

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April 25, 1982, Sunday, Late City Final Edition

SECTION: Section 3; Page 2, Column 3; Financial Desk

LENGTH: 1165 words

HEADLINE: HOW COMPANIES SHOULD USE THEIR CASH

BYLINE: By William M. Agee

BODY:

Being "cash-rich" is sometimes considered a negative for a business, somehow suggesting that management does not know how to put the money to work. A pile of cash, it is said, may make one vulnerable to a takeover; at the very least, a hoard may look unbusinesslike.

People often assume that the ability to do well in operations is the antithesis of working successfully with money. I believe that the contrary is true.

Business managers, typically and understandably, have functioned within conventional rules. They have sought to do the job better that [sic] they have always

done, i.e., run their basic businesses well, maintain market share, meet production goals, invest in new product development. These are all fairly standard criteria that shareholders expect from management. And in many cases this is still a prudent strategy.

Thus, what I am about to say does not apply to every situation, but it is my belief that today and in the years ahead, business leaders need to develop an additional dimension to their traditional approach to management.

Events and experience are teaching us that it is not only possible, but highly desirable for the managers of major corporations to perform well in the financial arena, as well as basic corporate operations. Skills in each need not conflict. They can ben [sic] counterbalancing and provide dimension and flexibility to management.

In the future, most managers must have the skills to run a portfolio of assets whether they be cash, securities or investments in companies.

An emphasis on financial flexibility is a sharp change from past attitudes, but in many cases it is likely to be the best way to make the most of shareholders' value over time, while adding to the vitality of the United States economy.

Successful financial strategies in the 1980's, I believe, will often involve owning minority positions in other companies. Taking a minority position represents a half-way house between holding cash or marketable securities, and buying 100 percent of a business. With a minority interest, management can make more money for its stockholders in the short term, enhancing for the long

term a company's financial strength. A company with a minority position possesses an ease of exit greater than those who buy 100 percent. Thus, its financial flexibility is far greater, and it is not caught in the unprofitable position of overpaying for its purchases.

In most 100-percent acquisitions, even in the currently depressed stock market, the final purchase price is generally well above what could be called retail prices. This "retail-plus" situation comes about because there is usually a bidding contest, or a takeover battle, that can dramatically run up the price. Such a premium is advantageous for the original shareholders, and often the arbitragers, but it reduces the net value to the acquirer.

These price wars have taken place at a time when most companies on the stock exchange are commanding only "wholesale" values, or even less—what one could call "wholesale-minus." Bargains literally abound.

Is it not a paradox, therefore, that today if you want to own 100 percent of a company you have to pay above the retail price, but if you want to take a minority position, you can get if [sic] for under wholesale? An intelligent strategy should take advatage [sic] of this situation, and managers should be prepared to adapt their strategies to such developments as they occur.

A company that is in the fortunate position of having excess cash, or excess borrowing capacity, at a time when its basic businesses are wellfunded—and which do not want to commit additional financial resources to them—has several options.

These include investing in marketable securities or short-term Government debt, buying back its own stock,

buying 100 percent of another business, or purchasing blocks of stock in other companies.

I believe that executives who find themselves in this enviable position shoud [sic] consider all these options. They should not back away from taking a portfolio position because it is against tradition, because it is not a "comfortable fit" or because Wall Street may not like it. In fact, managers have a responsibility to their shareholders to consider, among other things, the retail-plus, wholesale-minus paradox.

At Bendix, we have found this approach to be very useful. When we wanted to sell our interest in Asarco, our forest products line and other smaller businesses, questions were raised as to what we would do with all that money—some $700 million in cash. We believe that there is a time to sell and a time to buy, and while the two strategies might not always coincide, management should have the strength of conviction not to feel uncomfortable under those circumstances.

With that cash at our disposal, the timing of a purchase is ours. In the meantime, we have managed those funds prudently in the best interests of our stockholders.

This kind of financial flexibility is part of a four-faceted investment program for Bendix. The others are interests in new ventures that can open technological windows of opportunity for us; extensions of existing business that can improve our market position, increase our competitive effectiveness and expand long-range potential, and entry into major businesses that can provide additional dimensions to the company.

At a time when the world is changing so rapidly and the uncertainties are greater than at any time in the life of active executives, among a company's greatest assets are financial strengths, financial flexibility—and the management mentality to move into opportunities that exist outside the traditional framework.

I should emphasize that before embarking on this strategy, management must be fully funding its own programs that have the highest returns and the best growth prospects. It must never starve them. But as it does set about executing this strategy, management will force itself to be more tough-minded about allocation of capital to existing operations.

This strategy appears to be particularly timely right now, when most businesses have excess capacity and are nervous about their ability to earn a fair return on their existing businesses in the near term. It forces decisions upon them to manage their pools of assets for stockholders in ways that prepare soundly for a future that is more uncertain and less ebullient.

So the time is right for consideration of creative investment policies, including some that have been considered nonbusinesslike in the past.

GRAPHIC: Illustrations: drawing

SUBJECT: EXECUTIVES AND MANAGEMENT; CORPORATIONS; FINANCES; INVESTMENT STRATEGIES

Tax Court of New Jersey

Docket No. 14-24-0504-84-CB

(Caption omitted in printing)

Affidavit of
Harbir Singh

HARBIR SINGH, of full age, being duly sworn according to law, upon his oath, deposes and says:

1. My name is Harbir Singh. I make this affidavit for use by the State of New Jersey in connection with the above-captioned litigation.

2. The opinions expressed in my report dated January 7, 1987, which is attached hereto are my best professional judgment and are based upon my review of the materials listed in my report, my professional experience in the area of corporate strategy and corporate acquisitions, and upon accepted principles of strategic management.

3. A copy of my *curriculum vitae* is attached to my report.

/s / Harbir Singh
Harbir Singh

(Certification of Notary Public, dated June 19, 1987 omitted in printing)

BENDIX CORPORATION v. DIRECTOR, DIVISION OF TAXATION

STATEMENT OF PROFESSOR HARBIR SINGH

My name is Harbir Singh. I am Assistant Professor or [sic] Management at the Wharton School of Business of the University of Pennsylvania. I have a Ph.D. in Management from the Graduate School of Business of the University of Michigan. My area of professional specialty lies in the area of corporate strategy and corporate acquisitions. I teach principles of strategic management both to graduate student degree candidates and to middle and senior management interns at the Wharton School. A copy of my *curriculum vitae* is attached to this statement.

I have been asked by the Division of Law of the Department of Law and Public Safety of the State of New Jersey to give my professional opinion on the question of whether the acquisition by the Bendix Corporation of a minority interest in ASARCO, the holding of that interest and the subsequent disposition of the interest by Bendix, should be regarded as an investment having no relationship to the central corporate strategy and operations of the Bendix Corporation.

For this purpose, I was asked to examine, and have examined, the following documents:

1) Memorandum dated April 12, 1978, from W.M. Agee to Bendix Board of Directors included in the minutes of the meeting of the Board of Directors of Bendix Corporation, dated April 13, 1978.

2) Memorandum from W.M. Agee to members of the Long Range Planning Committee—Bendix Corporation, dated March 31, 1978.

3) Deposition of W.M. Agee, August 21, 1986.

4) Court decision in *ASARCO Inc. v. Idaho State Tax Commission*, June 29, 1982.

5) Article by W.M. Agee in the *New York Times*, April 25, 1982, entitled "How Companies Should Use Their Cash."

6) Court decision in *Silent Hoist & Crane Company, Inc. v. Director, Division of Taxation*, June 26, 1985.

On the basis of these documents, and in terms of widely accepted principles of strategic management, my conclusion is that the acquisition of a minority interest in ASARCO was an integral part of the strategic plan of the Bendix Corporation at the time of acquisition, that the minority interest continued to be evaluated subsequently as an integral part of the constituent business of what was then the Bendix Corporation and that the disposition of that interest was part of a general restructuring of the Bendix Corporation and thus an integral part of the corporation's strategic plan. In what follows, I have outlined the basis for this conclusion.

Accepted principles of strategic management, as taught in many major graduate schools of business and management, indicate that it is the responsibility of modern management to oversee the development of a coherent corporate-wide strategic plan, with a long-range (5-10 year) horizon to evaluate performance in existing

markets and to determine new markets for possible investment by the corporation.

In that planning process, top management will determine the markets and businesses in which the corporation will participate and the level of capital investment necessary to compete effectively in each of the individual markets selected.[1] The fundamental objective of top management is seen as the maximization of stockholder returns on their investment in the corporation.[2] Accordingly, effective competition by the corporation in its markets is calibrated in terms of the returns of its investment in each such market.[3]

The role of the corporation's top management necessarily involves, therefore, continuous identification of investment opportunities through which the corporation can earn returns for its stockholders. Those investment opportunities can take the form of new start-up ventures, acquisitions, joint ventures or minority stock interests in other corporations.

The logic underlying this range of possible modes of maximizing stockholder returns is that the firm will obtain returns from a portfolio of its investments, some involving full operating control of the productive assets (acquisitions and internal ventures), and others involving partial ownership of the productive assets (joint ventures and minority investments). In the latter category, returns for stockholders may be obtained through the corporation's share of the earnings of that business during the period the corporation owns the stock position and through capital gains obtained when its stake in the operating business is sold. The goal of maximizing stockholder returns is evident in the memorandum of W.M. Agee dated March 31, 1978, to the

long-range planning committee of Bendix's Board of Directors, in which Mr. Agee proposes the acquisition of an interest in a mining company and focuses on two candidates, one of which ("Blackie") was ASARCO. The argument made was two-fold. Mr. Agee saw acquisitions as the vehicle for realizing Bendix's growth objectives, and some sectors of basis resource industries (copper mining in particular) were undervalued assets in the capital markets. The memorandum clearly appears to be part of a well-articulated strategic plan, with clearly stated growth objectives and clear arguments for the choice of new investment opportunities for maximizing stockholder returns.

Another reason for the ASARCO investment was suggested by Mr. Agee in his deposition and in his article in the *New York Times*. At the time of the ASARCO investment, Bendix's basic operations were well-funded and the company had excess capital available. The ASARCO investment represented a way of strengthening the company financially and of maximizing shareholder value (Agee deposition, pp. 59-60). The consistency of this statement with the established principles of strategic management to which I referred earlier is striking.

The further analysis in Mr. Agee's March 31, 1978 memorandum concerning areas for acquisitions and the focus on two alternative acquisition candidates in the mining industry—examining the principal strategic resources of each candidate and comparing with a carefully selected list of desired attributes of an ideal candidate—indicates meticulous care in the development of the corporation's acquisition strategy. The eventual decision to obtain a minority position in ASARCO as against a controlling interest rested upon the assessment of ASARCO's response to a takeover bid, upon the extent

of investment necessary to make a controlling acquisition, upon the ability with a minority position to learn more about the industry before risking a greater financial commitment and upon the capability of making other acquisitions at the same time. Having determined that a key resource generating high future returns was the quality and commitment of ASARCO's current management, Bendix decided to opt for a minority position in ASARCO along with representation on the ASARCO Board.

The relationship between the acquisition of a minority interest in ASARCO and Bendix's other operations is also made clear in the memorandum of W.M. Agee of April 12, 1978 to the Bendix Board of Directors (attached to an excerpt from the Board's minutes of April 13, 1978). This analysis is again well-articulated and remarkably consistent with accepted normative views on the role of top management in the publicly-held corporation. It also indicates clearly the trade-off among alternative courses of investment action, and the integral nature of the corporate decision-making process.

The role of the ASARCO investment in the corporate strategy of the Bendix Corporation is also clear from the circumstances surrounding the sale of Bendix's interest in that firm. Mr. Agee's published article in the *New York Times* and Mr. Agee's deposition suggest that Bendix's minority interest in ASARCO was sold along with other noncore Bendix businesses as part of a major corporate restructuring, the goal of which was to focus the corporation more heavily on high technology businesses (Agee deposition, pp. 77-79). Among the noncore businesses which were sold at the time were Bendix's two investments in natural resources—the forest

products business and the mining business—specifically Bendix's minority interest in ASARCO. (Agee deposition, pp. 41-42, 78-79). The various sales, including Bendix's minority interest in ASARCO, generated some $700 million in cash. The sales created both excess cash and debt capacity thus enabling Bendix to make a tender offer for its largest acquisition to date. The target was Martin Marietta Corporation, which was very complementary to Bendix in the aerospace part of Bendix's business. (Agee deposition, pp. 79-80; 99-101). Pending application of the $700 million in cash, a portion of this amount was placed with Lehman Brothers in a highly liquid money market account. (Agee deposition pp. 81-84). The funds in the account were available on short notice to implement an acquisition (Agee deposition, p. 84).

As I stated earlier, one of the roles of top management is identification of the business and markets in which the corporation will participate and selection of investment opportunities through which the corporation can earn returns for its stockholders. Mr. Agee's deposition makes clear that he performed this function as chairman of Bendix. It was Mr. Agee's decision to buy an interest in ASARCO and to sell the interest. (Agee deposition, pp. 36, 39). Mr. Agee also made the decision to sell United Geophysical Corporation and to attempt to buy the stock of Martin Marietta Corporation (Agee deposition, pp. 37, 39). In fact, while he was chairman, Mr. Agee approved all of Bendix's acquisitions. (Agee deposition, p. 27). It is simply not possible to regard each of Bendix's investments, carried out as part of the strategic plan of a single corporate entity and conceived and considered by a single decision-making managerial body, as independent activities.

As I indicated earlier, my reading of the documents listed at the beginning of this statement, together with my professional understanding of the principles of strategic management as applied to these circumstances and as communicated to students and management practitioners, leads to my conclusion that there is no doubt the acquisition by the Bendix Corporation of a minority interest in ASARCO, and its subsequent holding and disposition, are properly viewed as an integral part of the strategic management of the overall resources of the Bendix Corporation.

/s/ Harbir Singh
Harbir Singh

DATED: January 7, 1987

Footnotes

1. Andrews, K.R., *"The Concept of Corporate Strategy,"* Homewood, Illinois, Dow Jones-Irving, 1971.

2. Salter, M.S. and W. Weinhold, "Diversification via Acquisition: Creating Value," pp. 166-176, *Harvard Business Review*, July-August, 1978.

3. Ellsworth, R.R. "Subordinate Financial Policy to Corporate Strategy," *Harvard Business Review*, pp. 170-182, November-December, 1983.

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Professional Appointments

Fall, 1983-present — Lecturer (1983-84)
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Spring, 1980-January, 1984 — Research Assistant and Doctoral Student
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Professional Associations

Editorial Board Member, *Academy of Management Journal*

Reviewer, *Strategic Management Journal*

Member of the Academy of Management, the Institute of Management Science and the Strategic Management Society

Professional Honors

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Education

Ph. D.	Graduate School of Business University of Michigan Ann Arbor MI 48109.
M.B.A.	Indian Institute of Management Vastrapur, Ahmedabad-38105.
B. Tech	Indian Institute of Technology New Delhi-110017.

Publications and Working Papers

"Diversification Strategy and Systematic Risk", (With C.A. Montgomery), *Strategic Management Journal*, June, 1984.

"Corporate Acquisitions, Diversification Strategy and Economic Performance", (With C.A. Montgomery) Reginald Jones Center Working Paper Series, (under second review, *Strategic Management Journal).*

"Product Market Relationships and Competition for Corporate Control", Management Department Working Paper No. 508, 1985 will be submitted to *Management Science.*

"Corporate Strategy and the Role of Acquisitions", (With P. Lorange and E. Kotlarchuk) in *Mergers and Acquisitions Handbook*, by Milton Rock, ed, McGraw-Hill, Forthcoming, August, 1986.

"Entering the United States by Acquisition or Joint Venture: Country Patterns and Cultural Characteristics", with Bruce Kogut, Reginald Jones Center Working Paper Series, will be submitted to *Journal of International Business Studies*.

"Strategic and Financial Planning: Towards an Integration", (With B.S. Chakravarthy) forthcoming in *Latest Advances in Strategic Management*, P. Shrivastava and R. Lamb, eds, 1986.

Corporate Acquisitions: Redefining the Scope of the Firm, University of Pennsylvania Press (under final negotiation) Spring, 1987.

"Why He Left: an Explanation For the Succession Effect", with Stewart Friedman, January, 1986, submitted for the Academy of Management Meetings, August, 1986 (project funded by the Reginald Jones Center, The Wharton School).

Papers Presented and Work in Progress

"The Effect of Raiders on Corporate Acquisition Activity", in progress, expected completion June, 1986.

"The Effects of Golden Parachutes on Contested Takeovers", in progress, expected completion by June, 1986.

"Foreign Entry Strategies: Acquisition, Joint Venture or Internal Development?", with B. Kogut, funded by the Reginald Jones Center, expected completion by August, 1986.

"Cooperative Ventures: Theory and Evidence" with B. Kogut presented at TIMS/ORSA Meetings in Boston, May, 1985.

"Product Market Relationships, Acquisitions, and Competition for Corporate Control", Presented at the TIMS/ORSA meetings, November, 1984.

"Corporate Acquisitions, Diversification Strategy and Performance", presented at the Academy of Management Meetings, August, 1984.

"Strategic and Financial Planning: The Twain Shall Meet", presented with B.S. Chakravarthy at the TIMS/ORSA Meetings at Copenhagen, June, 1984.

Doctoral Advising

Member of two Dissertation Committees—one in Management and the other in Decision Sciences. The Management dissertation relates to the organizational integration of corporate acquisitions and is being done by Mark Shanley.

Member of the Doctoral Admissions Committee headed by John Kimberly, helped in the entry decisions for 1985-86.

Teaching

Have taught Management One, Corporate Strategy, and Corporate Development. The course on Corporate Development is an MBA elective which has been very favorably received in the MBA program.

Executive Education: Have taught in the Strategic Planning Seminars consistently, and am now also teaching in the Management and Technology Seminar.

Tax Court of New Jersey

Docket No. 14-24-0504-84-CB

(Caption omitted in printing)

STIPULATION OF FACTS

IT IS HEREBY STIPULATED AND AGREED that for purposes of this action, the following statements may be accepted as facts and that all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part hereof; provided, however, that either party may object to the admission of such facts and exhibits into evidence on the grounds of materiality or relevance and either party may offer other further evidence not inconsistent with this stipulation. The submission of exhibits hereto does not necessarily indicate the agreement of the parties as to the truth of all matters contained in such exhibits. The truth of assertions within such stipulated exhibits may be rebutted or corroborated by additional evidence.

I. INTRODUCTORY MATTERS

1. The tax year at issue in this matter (as a result of the amendment of Bendix Corporation's ("Bendix") complaint) is the twelve month period ending September 30, 1981, and unless otherwise indicated all statements in this stipulation of facts pertain to Bendix's 1981 taxable/fiscal year. Bendix is on a September 30 fiscal year.

2. The amount of corporation business tax ("CBT") in dispute, which is claimed in refund by Bendix, is approximately $1,845,000. Attached hereto as

Exhibit A is a copy of Bendix's 1981 CBT return including portions of its *pro forma* 1981 federal income tax return. Bendix requested the refund sought (although in a greater amount than at issue in this proceeding) on its 1981 CBT return.

3. The tax at issue relates to three items of income which Bendix claims may not constitutionally be included by the Director in the income measure of its CBT liability. These items of income are:

(a) Capital gain in the amount of approximately $211.5 million realized on Bendix's sale of its 20.6% stock interest in Asarco, Inc. ("Asarco");

(b) Capital gain in the amount of approximately $41.9 million realized on Bendix's sale of the stock in its wholly owned subsidiary United Geophysical Corporation ("UGC"); and

(c) Interest earned in an account maintained by Bendix with Lehman Brothers, Kuhn Loeb ("Lehman Brothers") on the proceeds of the sale of Bendix's interests in Asarco and UGC, amounting to a portion of the total of approximately $12.7 million earned in the account in fiscal 1981.

4. Bendix does not dispute that its net worth for 1981 and the balance of its 1981 entire net income are subject to the CBT on an apportioned basis. The actual apportionment factor may, however, be based on a factor as determined through this action if Bendix's alternative claim described in paragraph 6 below is reached.

5. As audited, Bendix's apportionment factor pursuant to *N.J.S.A.* 54:10A-6 was 7.980727%.

6. In the event this Court determines that all or any part of the capital gains and interest income described in paragraph 3 above are properly includable in Bendix's New Jersey apportionable income, Bendix contends, in the alternative, as to any such includable capital gains and interest, that it is entitled to relief under *N.J.S.A.* 54:10A-8 in the form of the inclusion of Asarco's and/or UGC's (as the case may be) receipts, payroll and property in Bendix's 1981 apportionment factor to the extent of Bendix's stock interest in Asarco and/or UGC.

II. THE TAXPAYER

7. Bendix was incorporated in Delaware in 1929 as a manufacturer of aviation and automotive parts.

8. In 1937, Bendix obtained a certificate of authority to transact business in New Jersey and Bendix was qualified to transact business in New Jersey at all times relevant to this action.

9. In 1983 Bendix became a wholly owned subsidiary of Allied Corporation ("Allied") and was merged into Allied as of April 1, 1985.

10. At all times relevant to this action, Bendix's corporate headquarters and commercial domicile were in Southfield, Michigan.

11. Over the years, Bendix developed into a multinational corporation with activities, either directly or through subsidiaries or other operating units, in all 50 states and 22 foreign countries. Bendix's core

businesses expanded along several basic lines so that beginning in 1970 (when the forest products business was acquired) until 1981 (when the forest products business was sold) there were 4 major Bendix operating groups or sectors (the "Major Groups"): (a) automotive, (b) aerospace/electronics, (c) industrial/energy and (d) forest products. The various Bendix subsidiaries or other operating units were, for operational purposes, included by Bendix in one of the Major Groups based upon the type of business activity engaged in by that subsidiary or operating unit. Each subsidiary or operating unit had its own management which, in turn, reported to the chief executive of the Major Group in which the subsidiary or operating unit was included. The chief executives of the Major Groups reported directly to the chairman and chief executive officer of Bendix.

12. In fiscal 1981 Bendix had about 72,600 employees with 46,700 in the United States and 25,900 in Europe and other foreign locations. For fiscal 1981, revenues were $4,425,400,000, of which $3,117,600,000 derived from United States operations. Of these 1981 revenues, $2,176,500,000 derived from the Automotive Group, $1,468,700,000 derived from the Aerospace-Electronics Group and $784,900,000 derived from the Industrial Group. Miscellaneous income and intercompany eliminations reduced revenues by $4,700,000.

13. The principal products manufactured by Bendix during 1981 are described in Bendix's 1981 annual report attached as Exhibit B. The business of Bendix Forest Products Corp. ("BFPC"), which comprised the bulk of the Bendix forest products business, is described in an excerpt from Bendix's 1979 annual report attached as Exhibit C.

14. At all times relevant to this action, Bendix was under the supervision of a 17 member board of directors.

15. At all times relevant to this action, the chief executive officer of Bendix was called the chairman. Between 1965 and 1972, A.P. Fontaine was chairman. From 1972 to 1976, W. Michael Blumenthal was chairman. From January 1977 to June 1983, W.M. Agee was chairman.

16. At all times relevant to this action, the chairman was a member of the Bendix Board of Directors.

17. During the tenure of Mr. Agee as chairman, the officers of Bendix reporting directly to the chairman were the chief administrative officer, chief financial officer, head of the planning department/corporate development, and the presidents or chief executives of the Major Groups.

18. During Mr. Agee's chairmanship, there was an advisory group made up of senior management that met periodically. From 1980 onward, the group (which was designated the "chairman's council") included the president of each Major Group, the chief financial officer, chief technical officer, Bendix's general counsel, and the vice-president of corporate organization and human resources, who in that capacity was also head of Bendix's planning department. The purpose of the group was to assist in policy making. The group functioned in an advisory capacity; it did not have decisionmaking powers. Prior to 1980, commencing in 1977 and before the formal creation of a chairman's council, there was a chairman's advisory committee consisting of senior

Bendix management including the president of each Major Group, the chief financial officer, the head of the planning department and the chief administrative officer.

19. Reporting to the Chief Financial Officer of Bendix was the controller. The Bendix controller was the financial contact between the corporate headquarters in Southfield, Michigan and Bendix offices and operations throughout the United States and elsewhere. The controller had frequent contact with the Bendix chairman.

20. The controller's office was responsible for taxes, financial analysis, public reporting and internal reporting and accounting.

21. There was a controller's council, which consisted of the controller and his direct staff and the chief financial officers of the Major Groups. The controller's council generally met monthly to discuss subjects of interest to the controller and the financial officers.

22. During the course of each year that Mr. Agee was chairman, there were periodic budget reviews, operating reviews and strategic plan reviews.

23. In addition, during the course of each year that Mr. Agee was chairman, there were monthly operating group meetings which were attended by all the Major Group presidents and the controller. The meetings were for the purpose of exchanging information on various topics. There were also frequent reviews of Bendix operations throughout the United States and elsewhere.

24. Beginning in the late 1970's, Bendix began an annual process of preparing company-wide five year strategic plans. As part of this effort, each Major Group and each subsidiary or other operating unit within the Major Groups also prepared annual five-year strategic plans. Each such plan, whether for Bendix, a Major Group or a subsidiary or other operating unit, generally described the business outlook for the particular entity involved, reviewed the competitive position in its markets, described operating objectives and strategies, surveyed principal products and customers, described key issues or problems, provided financial data and analysis, discussed growth opportunities and, in some cases, discussed acquisition and divestiture possibilities.

25. Each subsidiary's or other operating unit's plan was reviewed at the Major Group level and, if approved, was ultimately, to some degree, incorporated and compiled into a strategic plan for the Major Group. Each Major Group's plan was then reviewed by the Bendix planning department and, following planning department review, would be presented to Mr. Agee and others selected to review it. Generally, there would be a meeting between personnel from the Major Group and the Agee reviewing group. Subject to that group's review and approval, portions of each Major Group's plan would be incorporated into the overall Bendix strategic plan for that year.

26. As described, the strategic plans fulfilled several general functions: the plans were attempts to identify future business prospects, problems and concerns relating to each entity for which a plan was prepared and they often contained proposals for addressing those business prospects, problems and concerns. To the extent approval of action of some type

was sought through the plan, after review and meetings between the members of the operating group which prepared the report and other analyses, the action sought was either approved and acted upon or approval was withheld.

27. In addition to reviewing the strategic plans of the various operating units and Major Groups, the Bendix planning department (which was located in Southfield, Michigan and performed all its functions in that location) considered, analyzed and developed long and short range business proposals for the various Bendix groups. Consistent with this objective, the planning department would analyze trends in the types of businesses Bendix was engaged in and ways to respond to those trends such as (i) increasing or decreasing capital commitment to particular products or services, (ii) greater or lesser expenditures by Bendix on research and development as to particular products or services, (iii) offering new or discontinuing (by divestiture of subsidiaries or other operating units or otherwise) existing Bendix products or services, or (iv) entry into a new product or service area either by developing the new product or service from within or by acquiring the assets, employees or technology for that new product or service through acquisition. The Bendix planning department, as the need arose, also evaluated acquisition candidates. While acquisition or divestiture was not the sole means of accomplishing certain of the above-mentioned objectives, Bendix, as many other major corporations, engaged in selected acquisitions and divestitures of companies or assets over the years.

28. As described by A. Matthew Lord, Director of Corporate Development in the Bendix planning department, during his tenure in the planning

department (1975-1982) Bendix had three major strategies for growth: (1) exploit its existing businesses, (2) move into related areas, and (3) move into unrelated areas with strong growth potential.

29. According to Mr. Lord, the long term goals for the Major Groups were:

> *Aerospace:* Move up on the scale to producing systems and subsystems rather than products and components.
>
> *Automotive:* Offer more products, particularly in the after market, which is more profitable than the original entry market.
>
> *Forest Products:* Integrate forward and avoid the cyclical problems of the market.
>
> *Industrial:* Look for good growth potential and similar returns in different segments of the market.

30. As part of a shift in strategy which began in 1980 (see ¶¶ 154, 155 hereafter), the Bendix planning department's function included two additional endeavors. The first of these involved the formation of a technical ventures group, which evaluated and recommended certain relatively modest acquisitions in high technology businesses. The acquisition of 20% of Maxwell Laboratories, Inc. for less than $50 million and of E-O Tech were part of the technical ventures program. Not including Maxwell, the total dollar value of the acquisitions in the technical ventures program did not exceed $20 million. The second endeavor was a screening program to select a major acquisition candidate in a high technology business. Over a period of nearly two years,

numerous companies were evaluated. One of the companies so evaluated was Martin Marietta Corporation ("Martin Marietta"). The Bendix planning group eventually recommended that Bendix consider the acquisition of Martin Marietta.

III. BENDIX IN NEW JERSEY

31. At all times relevant to this action, Bendix's New Jersey activities consisted primarily of the operation of several Bendix units in the Aerospace Group at Teterboro, New Jersey, including Aerospace Flight Systems, Guidance Systems and Test Systems and the manufacture of electric power generating systems at a plant in Eatontown, New Jersey.

32. The Bendix Aerospace Flight Systems Division in Teterboro developed and manufactured flight control systems, cockpit displays, flight and engine instrumentation, air data computers, engine control systems, air inlet control systems, pressure and position sensors and transducers, and weapon release and control systems. In addition, supporting maintenance and customer service were provided for all of the manufactured products. This division performed its own research, engineering, marketing, accounting and computer services necessary to support its basic manufacturing operations.

33. The Bendix Guidance Systems Division in Teterboro developed and manufactured inertial guidance equipment, gyroscopic devices, stabilization and control systems for space programs, and specialized missile and drone equipment. This division performed its own research, engineering, marketing, accounting and

computer services necessary to support its basic manufacturing operations.

34. The Bendix Test Systems Division in Teterboro developed and manufactured complete support systems for analog, digital, microwave and other devices, including the evaluation of test requirements, design and fabrication of test hardware and software, validation of test hardware compatibility, system configuration management, and logistic support of test systems. Test experience and hardware was available for, among other systems, air inlet control systems, armament control systems, automatic flight control systems, communications systems, display systems, navigation systems, and radar systems. This division performed its own research, engineering, marketing, accounting and computer services necessary to support its basic manufacturing operations.

35. At all time [sic] relevant to this action, other Bendix Aerospace activities in New Jersey included Bendix Computer Aided Engineering in Teterboro, which supported the computer aided engineering requirements of all Bendix aerospace businesses worldwide, and a small Bendix Avionics Division service facility in Morristown, New Jersey, which serviced and supported general aviation customers in central New Jersey.

36. The Bendix Electric Power Division in Eatontown developed and manufactured complete electric power generating and control systems, featuring brushless AC and DC generators, solid-state control and static power conversion equipment, power control and load sensing components, electric starting systems, electric system test and checkout systems, and other related electric power system components. This division

performed its own research, engineering, marketing, accounting and computer services necessary to support its basic manufacturing operations.

37. In addition to the foregoing New Jersey activities of Bendix's aerospace and electric power groups, at all times relevant to this action, Bendix Field Engineering Corporation, a wholly-owned subsidiary of Bendix, conducted two operations in New Jersey: (i) its Marine Science Services Division in Teterboro provided information to the worldwide ocean going shipping industry, including ocean current and weather information, and (ii) pursuant to a contract with the Federal Environmental Protection Agency ("EPA"), facilities management and maintenance support services were provided at an EPA facility in Edison, New Jersey.

38. At all times relevant to this action, Bendix also sold, both on a wholesale and retail basis, its full range of products to New Jersey customers and stored inventory in New Jersey at locations owned by others.

38a. The foregoing paragraphs 31 through 38 describe all the Bendix activities conducted in New Jersey at all times relevant to this action.

IV. ASARCO

39. Asarco (formerly known as American Smelting and Refining Co.,) was (and continues to be) a New Jersey corporation with its principal offices in New York, New York. At all times relevant to this action, Asarco was one of the world's leading producers of nonferrous metals, principally copper, lead, zinc and silver and nonmetallic minerals, including asbestos, coal, ilmenite and limestone. In addition to mining and

treating ore from its own mines, Asarco at all times relevant to this action was a major custom smelter and refiner of nonferrous metal ores mined by others. Asarco at all times relevant to this action conducted its own operations in the United States, Canada, Peru, and Bolivia, and also had substantial investments in other mining and metals companies through which mining operations were conducted in Australia, Mexico, Nicaragua, Peru and other foreign countries. These included M.I.M. Holdings Limited of Australia (48.9% owned), Mexico Desarrollo Industrial Minero, S.A. (34% owned), Neptune Mining Company (52.2% owned), Southern Peru Copper Corporation (52.3% owned), and Revere Copper and Brass Incorporated (33% owned).

40. At all times relevant to this matter, Asarco's sole activities (either directly or through subsidiaries) in New Jersey were the ownership of an ilmenite mine in Manchester, New Jersey, manufacturing by a subsidiary of additives, hardeners and other metal products at Newark and Trenton, New Jersey, manufacturing by a subsidiary of bronze rods, tubes, bearings, bushings and parts at Somerville, New Jersey, the rental of a management information service center in Cranford, New Jersey, the sale of its metal products to New Jersey customers and storage of inventory of such metal products at New Jersey locations owned by others. Asarco paid New Jersey corporation business tax with respect to these properties and income.

41. Prior to and after its investment in Asarco, no business or activity of Bendix (in New Jersey or otherwise), either directly or indirectly (other than the investment itself), was involved in the nonferrous metal production business or any other business or activity (in New Jersey or otherwise) in which Asarco was involved.

On its part, Asarco had no business or activity (in New Jersey or otherwise) which, directly or indirectly, was involved in any of the businesses or activities (in New Jersey or otherwise) in which Bendix was involved. None of Asarco's activities, businesses or income (in New Jersey or otherwise) were related to or connected with Bendix's activities, business or income (in New Jersey or otherwise).

42. Prior to the decision to invest in Asarco, the Bendix planning department conducted studies of both natural resource companies and the non-ferrous metals industry. A copy of an executive summary of natural resource companies is attached as Exhibit D.

43. Bendix began buying shares of stock in Asarco on the open market in December 1977 and completed its acquisition of 20.6% of Asarco's stock in November, 1978.

44. The reasons for Bendix's interest in a natural resource company are set forth in a memorandum of March 31, 1978 from W.M. Agee to the Long Range Planning Committee of Bendix's Board of Directors entitled "Long Range Growth and Acquisition Planning," a copy of which is attached as Exhibit E. The memorandum was authored by Jerome Jacobsen, head of Bendix's planning department, with review and input from Mr. Agee.

45. The March 31, 1978 memorandum discusses the areas of Bendix's business which have potential for growth and sets forth strategies for growth in three of those areas. The memorandum also focuses on the possible acquisition of a nonferrous metals company and in particular Asarco (called "Blackie" in the

memorandum), and provides reasons for acquiring approximately 20% of Asarco's stock. Attached to the memorandum are various supporting documents dealing primarily with the mining industry.

46. The Long Range Planning Committee of the Bendix Board of Directors recommended that the full Board of Directors approve the acquisition by Bendix of approximately 20% of the stock of Asarco.

47. The Board of Directors of Bendix met on April 13, 1978 and was presented with a memorandum dated April 12, 1978 from Mr. Agee requesting approval to purchase 15.1% of the stock of Asarco (4.9% having been previously acquired). A copy of an excerpt from the Bendix Board minutes of April 13, 1978, together with a copy of the memorandum of April 12, 1978 are attached as Exhibit F.

48. In addition to summarizing management's view that Bendix should acquire an interest in a company involved in basic commodities, particularly copper, the memorandum summarized Asarco's attributes, focused on the perceived unique aspects of the Asarco investment, outlined the broad parameters of the transaction, and set forth certain financial aspects of the investment.

49. Following presentation of the April 12, 1978 memorandum, the Bendix Board of Directors approved by resolution the acquisition of up to 21% of the stock of Asarco. A copy of the resolution is attached as Exhibit G.

50. Pursuant to a Stock Purchase Agreement dated as of April 13, 1978 (the "Agreement"), Asarco agreed to sell to Bendix 3,800,000 shares of Asarco stock.

A copy of the Agreement is attached as Exhibit H. Under the terms of the Agreement, Bendix agreed that prior to January 1, 1985 it would not either directly or through subsidiaries and affiliates hold in the aggregate more than 21% of the voting stock of Asarco. Further, Bendix agreed that in the event prior to January 1, 1985 it desired to sell 1,000,000 or more shares of its Asarco stock, it would provide to Asarco a right of first refusal at a price and on terms set forth in the Agreement. Additionally, Bendix agreed that prior to January 1, 1985 it would not solicit or permit any of its subsidiaries or affiliates to solicit proxies with respect to its Asarco stock or be, or permit any of its subsidiaries and affiliates to be, a "participant" in any "election contest" relating to election of directors of Asarco (as such terms are used in Rule 14a-11 of Regulation 14A under the Securities Exchange Act of 1934). The Agreement was to be governed by New Jersey law.

51. Through a series of further purchases either under option contracts or in the open market, Bendix acquired additional shares of stock of Asarco so that upon completion of all purchases it eventually owned 20.1% of such stock. Bendix maintained its investment in Asarco at a constant level of 6,106,900 shares which, upon retirement by Asarco of outstanding shares, became equal to 20.6% of Asarco's outstanding stock.

52. The total purchase price paid by Bendix for 20.6% of Asarco's stock was $127,649,017. The purchase price was paid by Bendix in cash, with $110 million of this purchase price being borrowed by Bendix under line of credit arrangements with its bank lenders. The balance of the cash purchase price was derived from internally generated funds.

53. While Bendix held the Asarco stock, Asarco agreed to recommend that two seats on Asarco's fourteen-member Board of Directors be filled by Bendix's representatives. These seats were filled by Mr. Agee and Malcolm Baldridge, a Bendix outside director.

54. Bendix did not exert any control over Asarco.

55. Because Bendix owned at least 20% of Asarco's stock, it was able to account for the investment under the equity method. Under this method, Bendix included in its income the share of Asarco's total earnings equal to Bendix's percentage of Asarco's stock, *i.e.*, 20.6%.

56. In order to report its investment in Asarco on the equity method, every fiscal quarter two or three individuals from Bendix's controller's department would visit Asarco's headquarters in New York and review Asarco's books and, at other times throughout the year, financial materials were supplied by Asarco to Bendix over the telephone or through the mails.

57. The Bendix Board of Directors met approximately five to six times a year. At every Board meeting during the period Bendix held at least 20% of Asarco, there was a report to the Board on Asarco's earnings. Copies of the relevant portions of certain Board minutes and Mr. Agee's reports to the Bendix Board on the Asarco investment at the meetings of October 26, 1978, February 12, 1979, April 26, 1979, June 18, 1979, October 25, 1979, January 31, 1980, April 24, 1980, June 26, 1980 and August 28, 1980 are attached as Exhibit I.

58. Over the years Bendix held its investment in Asarco, the economic outlook for the nonferrous metal industry greatly improved and the trading price of Asarco's stock increased as did its dividend payments.

59. The October 25, 1979 status report on the Asarco investment stated that Asarco contributed 82 cents per share to Bendix's earnings for Bendix's fiscal year ended September 30, 1979. Bendix's total earnings per share for fiscal year 1979 were $7.10.

60. The August 28, 1980 status report estimated that Asarco would contribute $2.22 per share to Bendix's 1980 earnings. Bendix's total earnings per share for fiscal year 1980 were $7.68.

61. With the approval of Bendix's Board, in September 1979, W.M. Agee made a proposal to Asarco's Board of Directors that the two companies consider a merger or other business combination. Asarco's Board did not wish to pursue discussion of any such transaction.

62. During the period that Bendix held its investment in Asarco, Bendix and Asarco were unrelated business enterprises each of whose activities had nothing to do with the other. As examples of this independence:

- There were no common management, officers, or employees of Bendix and Asarco.

- There was no use by Bendix of Asarco's corporate plant, offices or facilities and no use by Asarco of Bendix's corporate plant, offices or facilities.

- There was no rent or lease of any property by Bendix from Asarco and no rent or lease of any property by Asarco from Bendix.

- Bendix and Asarco were each responsible for providing their own legal services, contracting services, tax services, finance services and insurance.

- Bendix and Asarco had separate personnel and hiring policies (Agee) and separate pension and employee benefit plans.

- Bendix did not lend monies to Asarco and Asarco did not lend monies to Bendix.

- There were no joint borrowings by Bendix and Asarco.

- Bendix did not guaranty any of Asarco's debt and Asarco did not guaranty any of Bendix's debt.

- Asarco had no representative on Bendix's Board of Directors.

- Bendix did not pledge its Asarco stock.

- As far as can be determined there were no sales of product by Asarco itself to Bendix or by Bendix to Asarco. There were certain sales of product in the ordinary course of business by Asarco subsidiaries to Bendix but these sales were minute compared to Asarco's total sales of $1.7 billion in 1979 and $1.8 billion in 1980. The amounts of these sales are set forth in

Exhibit J. These open market sales were at arms length prices and did not come about due to the Bendix investment in Asarco.

- There were no transfers of employees between Bendix and Asarco.

63. In the fall of 1980, Bendix publicly announced that it was considering the possibility of selling its stock in Asarco. On October 7, 1980, Mr. Agee reported to the Bendix Board of Directors on his discussions with Asarco concerning the possible sale of Bendix's stock in Asarco to Asarco. While two members of the Bendix planning department testified that they did not conduct studies involving disposition of the Asarco investment, the Board was presented with and discussed materials presented by a managing director of Lehman Brothers concerning a possible sale of Bendix's stock in Asarco. The Bendix Board then authorized Mr. Agee to enter into an agreement to sell all or a portion of the Asarco stock at no less than $53 per share. A copy of an excerpt from the Bendix Board minutes of October 7, 1980 and an excerpt of the materials presented by Lehman Bothers are attached as Exhibit K.

64. Among the reasons for selling Bendix's interest in Asarco were (i) Bendix had decided to reduce its investment in businesses tied to natural resources such as BFPC and Asarco, and (ii) Bendix's investment in Asarco had appreciated considerably.

65. Asarco had a right of first refusal under the Agreement if Bendix desired to sell more than 1,000,000 shares of stock of Asarco. Upon negotiations with Bendix, Asarco agreed to repurchase its stock from Bendix.

66. On October 29, 1980, Bendix and Asarco entered into an agreement under which Asarco agreed to repurchase the shares owned by Bendix at $55 per share. The sale agreement was to be governed by the laws of New Jersey, and the closing was to occur in Morristown, New Jersey, at the offices of counsel of Asarco.

67. In the first half of 1981, Bendix sold its 6,106,900 shares in Asarco back to Asarco at $55 per share for a total sale price of approximately $335,879,500, of which approximately $211,500,000 was the long term capital gain at issue in this matter.

V. UNITED GEOPHYSICAL CORPORATION

68. Unless otherwise specified, the statements pertaining to UGC apply to the period 1965-1981.

69. In 1965, Bendix purchased 100% of the stock of UGC for stock in Bendix valued at approximately $6.2 million. Bendix sold 100% of the stock of UGC in July 1981 to Seiscom Delta, Inc. for cash amounting to approximately $80 million.

70. The purchase by Bendix of UGC was part of an effort by Bendix to diversify. It was also hoped that the business of UGC would complement existing Bendix oceanic endeavors. Bendix's 1965 Annual Report to Shareholders states at page 3:

> We have accelerated our acquisitions program. Here our objective is not merely diversification. We intend to achieve a better balance of our military and commercial-industrial product sales. We intend to enhance and improve our competence in the fields where Bendix's

> leadership and talents are acknowledged by acquiring strong units that are supplementary. In May [1965] we acquired the United Geophysical Corporation. This well-established organization is active world-wide in providing geophysical services to oil companies. Complementing our substantial oceanics endeavors, this acquisition will enable us to participate more fully in geophysical operations for petroleum and other minerals on a global basis.

71. UGC was in the business of seismic surveying, which involves the creation of underground acoustical waves through blasting or mechanical means and the recordation and interpretation of the wave patterns for purposes of locating oil and gas. A more detailed description of UGC's business is set forth in a draft prospectus dated June 18, 1981, an excerpt of which is attached as Exhibit L. UGC's principal customers were oil and gas companies.

72. UGC transacted no business in New Jersey.

73. Prior to acquiring UGC, neither Bendix nor any subsidiaries or affiliates were involved in the business of seismic surveying.

73a. No group or unit of Bendix (other than UGC) was engaged in the same business as UGC either in 1965 or at any other time.

74. From 1965 to 1968, UGC was included in Bendix's oceanics group. In 1968, the oceanics group was disbanded. Thereafter for a period of time, UGC was included in Bendix's Industrial/Energy Group, which included in addition to UGC, Texas Pipe Bending Corp.

and Skagit Corp. In later years, the Bendix Aerospace Group had some oversight over UGC.

75. UGC's Board of Directors consisted generally of four or five individuals. UGC had several officers. Attached hereto as Exhibit M is a list showing UGC's directors and officers from May 1965 to December 1972 and from February 1977 to July 1981. The individuals who were simultaneously employees of Bendix are starred (*) and those who had been employed by Bendix prior to becoming employees of UGC are doubled [sic] starred (**). John C. Fontaine (***) was a partner in Hughes, Hubbard and Reed, Bendix's outside counsel. The positions held by these individuals at Bendix are listed on Exhibit N.

76. Certain senior management of UGC were supplied by Bendix. Murray Weingarten was vice-president of operations at Bendix Field Engineering Corporation ("BFEC") when in 1967 he became president of UGC. He replaced UGC's then president, who had been carried over in that position when Bendix acquired UGC.

77. Mr. Weingarten remained at UGC until 1971 when he was made president of Skagit Corp., another Bendix subsidiary.

78. Bendix brought Mr. Weingarten to UGC because Bendix believed that his experience managing BFEC, which, like UGC was a service business (albeit one which provided entirely different services than those provided by UGC), might be helpful in operating UGC and addressing certain of UGC's problems which were resulting in losses.

79. Under Mr. Weingarten, UGC was reorganized. There was a significant reduction in UGC's staff. Individuals were asked to leave because Mr. Weingarten believed that UGC was overstaffed. Fewer people were authorized to enter into agreements on behalf of UGC or otherwise bind UGC. Mr. Weingarten initiated certain new personnel policies at UGC.

80. Mr. Weingarten brought two additional Bendix employees into management positions at UGC—R. M. Marshall, who became controller and assistant secretary of UGC and C. M. Edwards, who became director of engineering at UGC. Other than these management level appointments, there were few transfers of employees between Bendix and UGC. Bendix approved the hiring and salaries of individuals reporting directly to Mr. Weingarten.

81. In approximately 1969, Mr. Weingarten recommended to Bendix that UGC end its involvement in marine exploration, which contributed roughly 90% of UGC's losses. The recommendation was not accepted at the time as Bendix hoped that oceanography (underwater mining) would eventually become profitable.

82. As president of UGC, Mr. Weingarten had telephone contact approximately twice a week with his immediate superior at Bendix and personal contact with that person approximately once or twice a month.

83. For a period beginning in 1973 until Bendix sold its stock in UGC in 1981, W. Grogan Shelor, vice-president and group manager of the Bendix-Aerospace Group, was the person at Bendix to whom the President of UGC reported. When Mr. Shelor was in this role, he

was in contact by telephone with UGC's president approximately every other day, and made personal visits to UGC approximately once a month. During the latter part of the period that Bendix owned UGC, the President of the Bendix Aerospace Group, W.C. Purple, would accompany Mr. Shelor or his successor to UGC at least once a year.

84. Bendix approved UGC's annual financial plan. UGC would submit a proposal; Bendix would comment; if necessary the plan was revised and eventually a UGC financial plan would be accepted. The plan would discuss UGC's business projections and needs, estimate its capital needs, and project its profit goals.

85. Bendix's Board of Directors approved UGC's requests for capital expenditures above a certain dollar limit.

86. UGC provided Bendix with various periodic reports on its activities. These included:

- monthly status reports which described UGC's operations, including the number and location of its seismic crews;

- monthly and annual financial reports;

- quarterly census reports setting forth the number of UGC's employees and their salaries;

- periodic affirmative action reports.

87. UGC provided Bendix with safety and accident reports as needed.

88. There were some management conferences between Bendix and UGC's managment [sic].

89. As was true for other Bendix divisions, affiliates or subsidiaries (except minority investments such as Asarco), in the latter 1970's, UGC submitted annual strategic plans to Bendix. These plans would be reviewed by the Bendix group executive in charge of UGC, discussed with UGC, and either accepted or revised.

90. Bendix's audit staff audited UGC approximately every 18 months. The audit involved sending Bendix employees to UGC's headquarters to review UGC's books and accounting practices.

91. Shortly after Bendix acquired UGC, it financed the construction of two ships for UGC at approximately $1 million each to be used in marine seismic exploration.

92. UGC's employees were eligible to participate in Bendix's Salaried Employees Savings and Stock Ownership Plan and between 600 to 1600 UGC employees actually participated.

93. Bendix guaranteed UGC's workers compensation liability in California where UGC self-insured its liability, and UGC participated in Bendix's workers compensation insurance plans.

94. The Bendix logo appeared on certain UGC equipment, such as the two ships financed by Bendix, and during the latter portion of the period 1965-1981, sometimes on UGC's stationery and memoranda.

95. UGC was included under Bendix's insurance policies, and Bendix insurance personnel gave consultation to UGC on insurance matters.

96. Bendix provided UGC with legal advice when requested and routine legal services such as corporate filings and maintaining of corporate minutes.

97. Bendix provided tax advice to UGC, handled tax audits, and prepared UGC's federal, state and local corporate income and franchise tax returns. UGC prepared its own sales tax, property tax, and foreign tax returns.

98. During the latter part of the period when Bendix owned UGC, UGC's computer was connected via telephone lines to a central computer in Ann Arbor, Michigan used by Bendix.

99. Bendix charged UGC through the intercompany accounts for many of the services described in paragraphs 90, 93 and 95-98 above. As shown on Exhibit O, some of the services were separately itemized and others were included in a central office assessment ("COA"). Bendix charged a COA to many subsidiaries in order to compensate Bendix for support services supplied to those entities. The rate charged by Bendix as COA was determined by the general level of services rendered to a particular subsidiary, and the rate was applied to the subsidiary's sales. Immediately preceding its sale by Bendix, UGC's rate of assessment was half the maximum rate charged to other subsidiaries. This reduced COA reflected the fact that UGC was able to independently provide certain support services without resort to Bendix staff or facilities.

100. UGC's quarterly pension liability, workers' compensation accrual, and monthly profit sharing (Bendix Salaried Employees Savings and Stock Ownership Plan) plan liability were transferred to Bendix through the intercompany accounts for funding by Bendix. UGC's account reflected corresponding liabilities. These UGC liabilities to Bendix were reflected in intercompany accounts known as the "open account" and the "note account."

101. No interest was charged on the debit balance in the intercompany open account for a period of thirty (30) days until the balance was transferred from the open account to UGC's note account. Interest was charged on the note account at a market rate. UGC generally did not pay interest for a given month; the amount of accrued interest was added to the note account.

102. Bendix made periodic short-term and long-term working capital loans to UGC, which were reflected in the intercompany note account. Exhibit P.

103. In October 1978 and again as of March 31, 1981, just prior to the sale of UGC, Bendix capitalized a portion of UGC's debt to Bendix. To reflect this capitalization, UGC's liability to Bendix was transferred from the liability to the equity portion of UGC's balance sheet, thereby eliminating UGC's fixed obligation to repay the debt.

104. The amount of UGC's debt capitalized by Bendix in 1978 was $8.2 million. The amount capitalized in 1981 was $2.9 million.

105. There was no sharing of patents, technology or know how between Bendix and UGC although the companies had a common patent department.

106. UGC had its own pension plan.

107. Bendix did not purchase goods from UGC.

108. As far as can be determined, UGC did not purchase goods from Bendix.

109. UGC did not perform services for Bendix. Other than as described above, Bendix did not provide services to UGC either directly or through any of its subsidiaries or affiliates.

110. Bendix did not pledge its UGC stock.

111. UGC and Bendix did not have a common personnel manual.

112. Bendix and UGC did not engage in centralized purchasing, have the same sales force or common advertising; did not have common banking facilities, and did not transfer by sale or lease real or personal property between each other.

113. Prior to the sale of UGC in 1981, the Bendix planning department evaluated UGC's future potential from the point of view of potential return on assets, possible acquisitions for UGC, and fit within Bendix. There appeared to be no appropriate acquisition targets and there was a lack of fit with Bendix. By this point, UGC was considered by Bendix to be within the Bendix natural resources industry group, and Bendix had determined to reduce its involvement in that area.

Attached hereto as Exhibit Q is a memorandum dated November 13, 1980 from Mr. Agee to the Bendix Board of Directors setting forth reasons for the sale of UGC.

114. Bendix's initial intention was to sell its shares in UGC to the public.

115. To prepare UGC to stand on its own for such a public sale, Bendix hired a chief financial officer for UGC and two to three key staff people.

116. The Bendix stock of UGC was sold to Seiscom Delta, Inc. in July 1981 for approximately $80 million.

VI. PROCEEDS FROM SALE OF ASARCO AND UGC STOCK

117. Bendix placed the proceeds from the sale of its 20.6% interest in Asarco and its stock in UGC in an interest bearing investment account (the "Account") with Lehman Brothers. The Account was administered, and all securites [sic] on deposit were located, outside of New Jersey.

118. The Asarco and UGC proceeds were placed in the Account on the following dates in the following amounts:

Asarco:	1/26/81	$ 210,881,000
	4/20/81	28,056,139
	5/29/81	102,772,897
	TOTAL	$ 341,710,036
UGC:	7/28/81	$ 80,000,000

119. Bendix deposited monies from other sources in the Account as well.

120. Total interest earned in the Account for fiscal year ending September 30, 1981 amounted to $12,702,331. See Exhibit R.

121. As shown in Exhibit S, under the FIFO method, interest earned in the Account in fiscal 1981 attributable to the Asarco and UGC proceeds respectively was:

Asarco	UGC
$1,330,021	$1,901,323

122. As shown on Exhibit T, under the LIFO method, interest earned in the Account in fiscal 1981 attributable to the Asarco and UGC proceeds respectively was:

Asarco	UGC
$1,989,403	$1,405,216

123. The investments in the Account were of a highly liquid nature generally with maturities of less than 90 days.

VII. OTHER BENDIX ACTIVITIES

a) Stock Repurchase

124. In late January 1981, Bendix made a public offer, valid until February 27, 1981, to purchase up to 4,000,000 of its shares at $64 per share and reserved the right to purchase an additional 1,000,000 shares.

125. As reflected in the filings made by Bendix with the Securities Exchange Commission in connection with this offer, the source of funds for the purchase of shares was the proceeds of Bendix's sale of its interest in Asarco and various subsidiaries.

126. Withdrawals from the Account in March and early April, 1981 were most likely used to pay for Bendix's purchase of its stock.

127. Bendix spent a total of $257.5 million on the purchase of its shares.

b) Bendix Acquisitions and Divestitures

128. Over the years Bendix engaged in selective acquisitions and divestitures of companies or assets of companies. While there were different reasons for each Bendix acquisition or divestiture, a major theme in this area, as expressed by Mr. Lord, a senior member of the Bendix Planning Department during Mr. Agee's tenure, was whether an acquisition or disposition would enhance the existing product areas of Bendix. For example, "a logical off-shoot of the businesses engaged in by the Automotive Group was the acquisitions of Fram Corporation (which made automotive oil and air filters) and Autolite (which made spark plugs). These two acquisitions were designed to expand Bendix's reach into the automobile "after market". Intended to broaden Bendix's product offering in the automotive field was the acquisition of Toledo Stamping and Manufacturing Company, a producer or [sic] engine rocker arms. The acquisition of Warner & Swasey Company enhanced Bendix's position in the machine tools business.

129. While Bendix owned BFPC, its forest products business, acquisition of Bass & Co. (retailer of specialty building materials), Caradco (maker of wood windows and doors), Modern Materials (maker of aluminum building products) and Coin Millwork (maker of moldings) was accomplished because these companies were involved in the manufacture, sale and distribution of products that utilized forest products as raw materials.

130. Bendix, on occasion, invested in or made an acquisition in business areas in which it had no existing specific involvement. Examples of this sort of activity included the purchase of UGC, BFPC, Skagit Corporation and the Asarco minority stock interest.

131. Suggestions for acquisitions or divestitures might come from various sources from within Bendix including a group or division's/strategic plan, the planning department or from senior management. If an acquisition or divestiture was considered, the analysis of the impact of that transaction upon Bendix and the relative merits thereof might be performed by the division or group from which the idea emanated or by the Bendix planning department. The controller's department generally would conduct financial analysis of the proposed transaction. Once all analysis and evaluation of the transaction were completed, the proposal would be presented to the chairman for review. No acquisition proposal or divestiture could be presented to the Bendix Board of Directors without the approval of the chairman.

132. Bendix's 1966 Annual Report to Shareholders lists the following acquisitions at page 5. (The acquisition's principal business is indicated in parentheses):

- Besly-Welles Corporation (grinding machines and metal cutting tools)

- P & D Manufacturing Company, Inc. (automotive ignition parts)

- Fonda Gage Company (precision gage blocks for the metalworking industry)

- Beck-Lee Corporation (medical electronics equipment for doctors)

- Scully-Jones Company (tool holders and cutting tools for machine tools)

- Marine Advisors, Inc. (applied oceanography)

- Mosaic Fabrications, Inc. (fiber optics producer)

133. Bendix's 1967 Annual Report to Shareholders lists the following acquisitions at page 9:

- Fram Corporation (manufacture and sale of filters for internal combustion engines)

- Macklin Co. (grinding wheels for the automotive, glass, and steel industries)

- Titan Abrasives Company (abrasive grinding disks for the cutting tool industry)

- Industrial Fabricating Company (heat exchangers)

- Texas Pipe Bending Company (minority interest; manufacturer of welded pipe for refineries, chemical and petrochemical plants)

134. In 1967 Bendix disposed of its Marine Division.

135. Bendix's 1968 Annual Report to Shareholders lists the following acquisitions at page 30:

- Fram Corporation purchased the shares of Superior Machine & Tool Co. (manufacturer of tools and dies).

- Certain assets of Roberts Toledo Rubber Co. (molded rubber products).

- Consolidated Vacuum Corp. (vacuum systems for industrial processing and scientific and research laboratories).

- Fram Corporation purchased Mercury Filter Corp. (industrial air filters).

- Geo Prospectors, Inc.

136. The Chairman's letter in Bendix's 1969 Annual Report to Shareholders recounts the history of Bendix which began as an aviation corporation supplying military systems, and states:

> Recognizing the vital necessity to broaden the base of our business so as to be less dependent on the government sector, we intensified our efforts to

expand in other commercial and industrial markets.

Page 4 of the same Report states:

> Acquisitions have played a significant role in the growth of your Corporation during the past decade.

137. Bendix's 1969 Annual Report to Shareholders lists the following acquisitions at page 13:

- Buhr Machine Tool Company (automatic transfer machines).
- American Abrasive Company (abrasive grains, powders and wheels).
- Skagit Corporation (logging equipment and systems and other handling equipment).
- Fram Corporation purchased Superior Filter Glass Corporation.
- Remaining 49% of the stock of Bendix-Westinghouse Automotive Air Brake Co.
- Remaining stock in Aviation Electric Ltd.

138. During 1969 Bendix disposed of:

- Computing Devices of Canada Ltd.
- Bendix's Semiconductor Division
- UGC sold its Houston data center

- Bendix's Scientific Instruments and Equipment Division sold its dosimeter business.

139. The Chairman's message in Bendix's 1970 Annual Report to Shareholders states that Bendix merged with American Forest Products Corporation during that year. This was Bendix's largest acquisition to date and represented a new market for Bendix. American Forest Products Corporation was in the timber management, lumber, building materials, wood and corrugated containers, and aluminum siding businesses.

140. Bendix's 1971 Annual Report to Shareholders at page 33 mentions six relatively small acquisitions during the year and the acquisition of 50% interests in two European companies.

141. The Chairman's message in Bendix's 1972 Annual Report to Shareholders states that Bendix is pursuing "broad corporate strategies to further increase the non-government segment of our business, to pursue the diversification of our major lines of business, to expand our role in non-cyclicial [sic] or counter-cyclicial [sic] markets and to increase our international involvement."

142. During 1973 Bendix acquired Boise Cascade's international mobile home and recreational vehicle businesses and reorganized these activities as Bendix Home Systems. During calendar year 1973 Bendix acquired the Autolite spark plug manufacturing facility and the Autolite trademark from the Ford Motor Company.

143. Bendix's 1973 Annual Report to Shareholders at page 1 discusses "the principle of diversification" and states that Bendix's markets and products "are not necessarily on the same business cycles." The 1973 Report states further at page 1:

> We also continued our policy of disposing of minor operations which do not relate to our long-range business strategy.

144. Bendix's 1975 Annual Report to Shareholders states at page 8 that one of the principles followed at Bendix "has been the careful diversification of the Company into four broad lines of business—automotive, aerospace-electronics, industrial-energy and shelter."

145. The 1975 Annual Report states that pursuant to an order of the Federal Trade Commission certain operations of Bendix and Fram Corporation were transferred to a new subsidiary, Facet Enterprises, which would be divested no later than November 1976.

146. The letter to shareholders in Bendix's 1976 Annual Report states that Bendix's earnings record in the fifties and sixties was "spotty" due to excessive dependence on government work and on "the cyclical ups and downs of the industries [Bendix] served".

147. Bendix's 1977 Annual Report to Shareholders states in the letter to stockholders that "we have pursued a deliberate policy of diversification both within and among our lines of business, and geographically as well, in an effort to arrive at a combination of activities that helps insulate the company as a whole from the ups and downs of any one of them."

Page 3 of the Report states that Bendix's acquisitions program has been a source of growth. This was the first of Mr. Agee's reports as chairman of Bendix. The Report notes at page 2 that one of the keys to Bendix's reputation for reliability and high quality is its technological strength. During 1977 Bendix acquired Coin Millwork, a maker of wood moldings.

148. The chairman's report in the 1978 Annual Report to Shareholders states that Bendix has "successfully pursued a strategy of diversification that has brought us resistance to the ill effects of swings in the business cycle. First, we are in four major businesses: automotive, aerospace-electronics, forest products, and industrial-energy. Second, within each of these, we are also diversified."

149. During 1978, Bendix acquired Toledo Stamping and Manufacturing Company, a manufacturer of engine rocker arms for cars and trucks, and two small companies manufacturing components in the aerospace-electronics area of Bendix's business and sold the North American Manufactured home and recreational vehicle operations of Bendix Home Systems.

150. The chairman's report in Bendix's 1978 Annual Report to Shareholders reports the "single largest investment," in the company's history—the acquisition of 18.4% (ultimately to become 20.6%) of the shares of Asarco. Page 8 of the Report states that the acquisition of an interest in Asarco "strengthens Bendix for the 1980's with a substantial diversification into nonferrous metals and minerals."

151. The letter to stockholders in Bendix's 1979 Annual Report to Shareholders states at page 3 that one

"strong element" in Bendix's strategy has been "a policy of diversification aimed at insulating the Company's total profitability from the cyclical troubles of any particular industry or business" and that another element in the strategy has been a "careful effort to seek out the high return, high-growth segments of the markets [Bendix] serve[s]."

152. During 1979 Bendix acquired Bass & Company, a producer and distributor of building materials, and the Caradco Division of Scoville, a producer of windows and sliding doors.

153. During 1980 Bendix acquired Warner & Swasey Company, a machine tool manufacturer for $300.7 million, Bendix's largest acquisition to date, and sold Skagit Corporation for $28.3 million.

154. In 1980 there occurred certain changes in strategy at Bendix. The basic thrust of this revised strategy was to focus more heavily upon the high technology aspects of Bendix's existing businesses and to examine acquisitions of companies in high technology businesses that either might complement those existing Bendix businesses or represent an entry into new areas. In addition to these efforts, Bendix established an Advanced Technology Center to undertake basic research and exploratory development.

155. As part of this shift in strategy, there was a re-evaluation by Bendix of its natural resource group which included BFPC, UGC and other companies and, for administrative purposes only, the Asarco investment. It was determined that continued involvement in these industries was not necessarily consistent with Bendix's desire to concentrate more significantly on developing its

own technological capabilities and on companies which would assist in that effort.

156. Consistent with these decisions and the shift away from the natural resource businesses, during its 1981 fiscal year (10/1/80–9/30/81), Bendix disposed of or agreed to dispose of:

- BFPC for $435 million.
- UGC for $80 million.
- Bass, Caradco, and Modern Materials for a total loss of $12.5 million.
- Its 20.6% stock interest in Asarco for $336 million.

157. The sale of BFPC was consistent with Bendix's determination to reduce its involvement in businesses tied to natural resources.

158. Bendix's 1980 Annual Report to Shareholders states in the chairman's message:

> Our investment in the forest products business and Asarco were made in line with our policy of diversification as an insulator against the cyclicality of any particular business...
>
> When consummated, the sales of the forest products business and our interest in Asarco will reflect the basic soundness of investing in them originally; will increase the company's financial strength substantially; and will leave us well positioned to make prudent investments in the

> future of Bendix. As always, the overriding criteria for new investments will be the maximization of stockholder value.

159. The Chairman's letter in Bendix's 1981 Annual Report to Shareholders states at page 6:

> Finally, our redeployment of assets through our divestment program also contributed significantly to net income in 1981. We completed our plan for major divestments with the sale of our forest product business, our interest in Asarco Incorporated, and the stock of our subsidiary United Geophysical Corporation.

160. The 1981 Annual Report to Shareholders states at page 7 that the net gains from Bendix's various divestments "allowed the company to purchase some four million shares of our own stock which should enhance future shareholder value."

161. The cash proceeds from the various sales which took place in fiscal year 1981, created liquidity and additional debt capacity to enable Bendix to be in a position to make a sizable acquisition if an appropriate acquisition candidate materialized.

162. On August 24, 1982, Mr. Agee requested authorization from the Bendix Board to make a public offer to purchase up to 50% of the shares of Martin Marietta, with the intent of acquiring the remaining 50% in exchange for Bendix shares. Attached as Exhibit U is a copy of Mr. Agee's memorandum of August 24, 1982 proposing acquisition of Martin Marietta (called "Georgia" in the Exhibit). Bendix subsequently increased its offer to purchase up to 70% of Martin Marietta's stock.

163. Martin Marietta's principal business was aerospace related, where it was a prime contractor producing entire systems, with a strong involvement in the production of missiles. Bendix had an aerospace group with a primary focus in aircraft, and was primarily a subcontractor of component parts. Bendix believed the businesses of Martin Marietta and Bendix were complementary.

164. Bendix purchased approximately 70% of the stock of Martin Marietta. The total cash purchase price for the Martin Marietta stock was slightly in excess of $1 billion and, with the assumption of Martin Marietta's debt, approached $1.5 billion. According to Bendix's 1982 Annual Report to Shareholders, Bendix incurred additional debt of $793.7 million and, decreased its cash and marketable securities by $424.1 [sic] primarily as a result of its purchase of the common stock of Martin Marietta.

165. Although Bendix succeeded in acquiring approximately 70% of Martin Marietta's shares, it was unable to call a meeting of the Martin Marietta shareholders before Martin Marietta acquired 50.3% of Bendix's shares. Allied then (1) purchased all the Bendix shares owned by Martin Marietta, (2) purchased all the Martin Marietta shares held by Bendix and (3) resold a large portion of the Martin Marietta shares to Martin Marietta. Allied then acquired the remaining Bendix

shares through a merger, and Bendix became a wholly owned subsidiary of Allied.

Respectfully submitted,

RIKER, DANZIG, SCHERER,
HYLAND & PERRETTI
Attorneys for Bendix
Corporation

Dated: June 22, 1987

By: /s/ Mark S. Rattner
Mark S. Rattner
A Member of the Firm

W. Cary Edwards
Attorney General of New
Jersey
Attorney for The Director,
Division of Taxation

Dated: June 22, 1987

By: /s/ Mary R. Hamill
Mary R. Hamill
Deputy Attorney General

BENDIX CORPORATION
v.
DIRECTOR, DIVISION OF TAXATION

LIST OF EXHIBITS TO STIPULATION OF FACTS

Exhibits

A. 1981 Corporation Business Tax Return (¶2)

B. 1981 Bendix Annual Report (¶13)

C. Excerpt from 1979 Bendix Annual Report describing forest products business (¶13)

D. Executive Summary from Robert O. Bradley to William Agee relating to study of national resource companies (¶42)

E. Memorandum dated March 31, 1978 from W.M. Agee to Long Range Planning Committee Entitled "Long Range Growth and Acquisition Planning" (¶44)

F. Excerpt from Bendix Board minutes of April 13, 1978, together with copy of memorandum of April 12, 1978 from William Agee regarding ASARCO (¶47)

G. Resolution of Bendix Board of Directors approving acquisition of up to 21% of the stock of ASARCO (¶49)

H. Stock Purchase Agreement dated as of April 13, 1978 between ASARCO and Bendix (¶50)

I. Reports to Bendix Board on status of ASARCO investment (¶57)

J. Excerpts from ASARCO proxy materials relating to sales of asbestos from ASARCO subsidiaries to Bendix (¶62)

K. Bendix Board Minutes of October 7, 1980 and excerpt of materials presented by Lehman Brothers at that meeting (¶63)

L. Excerpt from draft prospectus relating to public sale of UGC (¶71)

M. Listing of UGC directors and officers from May 1965 to December 1972 and from February 1977 to July 1981 (¶75)

N. Listing of common employees and directors of Bendix and UGC (¶75)

O. Central Office Assessment reports (¶99)

P. Intercompany note account documentation (¶102)

Q. Memorandum dated November 13, 1980 from William Agee to Bendix Board of Directors relating to sale of UGC (¶113)

R. Statement of interest earned in Lehman Brothers' account (¶120)

S. Interest earned in Lehman Brothers account attributable To ASARCO and UGC proceeds calculated on FIFO Method (¶121)

T. Interest earned in Lehman Brothers' account attributable to interest earned on ASARCO and UGC Proceeds on LIFO Method (¶122)

U. Memorandum dated August 24, 1982 from William Agee regarding proposed acquisition of Martin Marietta (¶162)

(Exhibit E appears on pp. J.A. 87–118 as Exhibit D-17 to the transcript of the deposition of W.M. Agee)

(Exhibit F appears on pp. J.A. 119–132 as Exhibit D-18 to the transcript of the deposition of W.M. Agee)

(Exhibits G, H, and J through T omitted in printing)

EXHIBIT A TO THE STIPU

STATE OF NE
CORPORATION BUSIN
(FORM CB

For the taxable year beginni
ending September 30, 1981

. . .

COMPUTATIO

. . .

SECTION II TAX BASED ON
ASSETS OR AUTHORIZED CA
3. AMOUNT OF TAX (from Sch
Item 12, Page 3) .....

SECTION III TAX BASED ON
NET INCOME
4. AMOUNT OF TAX (from Sch
Item 42, Page 2) .....

SECTION IV TAX COMPUTA
5. Total Tax Liability—Total Ite
applicable plus Item 4. Certain
Companies enter only Item 4 (s
Enter not less than $25.00 for a
corporation or $50.00 for a forei
corporation or $250.00 for an In
Co., Regulated Investment Co.
Estate Investment Trust .....

LATION OF FACTS

/ JERSEY
ESS TAX RETURN
-100)

g October 1, 1980, and

N OF TAX

ENTIRE NET WORTH,
PITAL STOCK
edule B-1,
..... 145,029

NTIRE

edule A,
..... 404,078

ION
1 2 or 3, as
utobus
e last.6(d)).
omestic
n
estment
r Real
..... 549,107

(Computation of Tax cont'd)

6. PREPAYMENT - All taxpayers must enter 60% of Item 5 (See Instruction 25) 329,464

7. Enter Total of Items 5 and 6..... 878,571

8. Credit - Prepayment, Tentative Payments and Overpayments—(See Instruction 36)

(a) Previous Year's Prepayment..... 282,022
(b) Total Payment made with 1980 Tentative Return 3,000,000
(c) Overpayment claimed as credits from 1979 Tax Return..... [Blank in Original]
Total 3,282,022

9.Balance of Tax Due (Item 7 Less Item 8)..... [Blank in original]

10. (a) Penalty [Blank in Original];
(b) Interest [Blank in Original];
(See Instruction 37). Total ..... [Blank in original]

11. Total Balance Due (Item 9 plus Item 10).....[Blank in original]

12.If Item 8 is greater than Item 7, Enter Amount of Overpayment 2,403,451
Amount of Item 12 to be Credited to 1981 Return..... [Blank in Original]
Refunded $2,403,451
(Certification and Verification omitted in printing)

* * *

THE BENDIX CORPORATION

STATE INCOME TAX CALCULATION

	RESULT
NET TAXABLE INCOME (L28 OF FED RETURN) - EV	534,780,569
TOTAL NET TAXABLE INCOME -	534,780,569
ADDITIONS	
OTHER ADDITIONS TO INCOME BEFORE APPORTIONMENT-WI	[Blank in Original]
STATE INCOME TAX - WI	2,900,632
TAX EXEMPT INTEREST INCOME - EV	[Blank in Original]
INT EXP TO 10 PCT OWN LESS HI $1000 10 PCT INT-EV	[Blank in Original]
TOTAL ADDITIONS TO FEDERAL INCOME	2,900,632
DEDUCTIONS	
OTHER DEDUCTIONS FROM INCOME BEF APPORTIONMENT-WI	[Blank in Original]
DIV INCOME FROM CORP AT LEAST 80 PCT OWNED - EV	206,043,847
50 PCT OF DIV FROM CORP LESS THAN 80 PCT OWNED-EV	3,515,250
FOREIGN TAX CR ON FOR INC (EXCL FOREIGN DIV) - EV	3,890,582

(State Income Tax Calculation cont'd)

TAX W/H AND DEEMED PAID ON FOREIGN DIV - EV	[Blank in Original]
NET CAP LOSS CO	
FED JOB + WIN CR EXP TAX EXEMPT	44,581
	[Blank in Original
TOTAL DEDUCTION FROM FEDERAL INCOME	213,494,260
FEDERAL TAXABLE INCOME ADJUSTED TO STATE BASIS	324,186,942
DIRECTLY ALLOCABLE ITEMS - EV	[Blank in Original]
MISCELLANEOUS NON-BUSINESS INCOME-EV	267,351,914
TOTAL DIRECTLY ALLOCABLE ITEMS - EV	267,351,914
BUSINESS INCOME TO BE APPORTIONED	56,835,028
APPORTIONMENT FACTOR	7.899628
APPORTIONED BUSINESS INCOME	4,489,755
DIRECTLY ALLOCABLE ITEMS - WI	[Blank in Original]
MISCELLANEOUS NON-BUSINESS INCOME-WI	[Blank in Original]

(State Income Tax Calculation cont'd)

TOTAL DIRECTLY ALLOCABLE ITEMS - WI	[Blank in Original]
TAXABLE INCOME BEFORE ADJUSTMENTS	4,489,755
DEDUCTIONS FROM TAXABLE INCOME	[Blank in Original]
OTHER DEDUCTIONS FROM INC AFTER APPORTIONMENT - W	[Blank in Original]
TOTAL DEDUCTIONS FROM STATE TAXABLE INCOME	[Blank in Original]
ADDITIONS	
OTHER ADDITIONS TO INCOME AFTER APPORTIONMENT - W	[Blank in Original]
TAXABLE INCOME AFTER ADJUSTMENTS	4,489,755
TAX RATE	9.00%
TAX BEFORE ADJUSTMENTS	404,078
ADDITIONS	
OTHER ADDITIONS TO TAX	[Blank in Original]
COMP TAX ON NET WORTH, CAP STOCK OR ASSETS - WI	145,029
TOTAL ADDITIONS TO TAX	145,029

(State Income Tax Calculation cont'd)

DEDUCTIONS	
OTHER DEDUCTIONS FROM TAX	[Blank in Original]
NET ADJUSTMENTS	145,029
FINAL TAX	549,107

* * *

THE BENDIX CORPORATION

APPORTIONMENT FACTORS

	RESULT
PROPERTY WITHIN	105,813,233
PROPERTY EVERYWHERE	932,955,427
PROPERTY PERCENTAGE	11.342260
PAYROLL WITHIN	86,980,620
PAYROLL EVERYWHERE	835,936,393
PAYROLL PERCENTAGE	10.405172
SALES WITHIN	42,398,118
SALES EVERYWHERE	2,172,646,697
SALES PERCENTAGE	1.951450
AVERAGE APPORTIONMENT PERCENTAGE	7.899628

* * *

THE BENDIX CORPORATION

CORPORATION TAX RETURN
FISCAL YEAR ENDED SEPTEMBER 30, 1981

ALLOCABLE NON-BUSINESS INCOME

Net Gain From the Sale of Stock and Securities	$243,952,176
Interest	23,399,738
Total Allocable Income - Everywhere	$267,351,914

Income which has no unitary business relationship to taxpayer under the principles described in *Asarco Inc. V. Idaho State Tax Commission*, U.S. Supreme Court, June 29, 1982, has been allocated as non-business income.

THE BENDIX CORPORATION
SOUTHFIELD, MICHIGAN
CORPORATION TAX RETURN
FISCAL YEAR ENDED SEPTEMBER 30, 1981

STATEMENT ON SCHEDULE A

The taxpayer is include [sic] in a consolidated income tax return for federal income tax purposes. Items 1 to 36 as reported on Schedule A of the New Jersey Corporation Business Tax Return are reported by the taxpayer on its own separate basis.

* * *

THE BENDIX CORPORATION

1120 INCOME TAX RETURN

	GROSS RECEIPTS OR GROSS SALES	2,162,905,517
	LESS: RETURNS AND ALLOWANCES	40,224,534
1	NET SALES	2,122,680,983
2	LESS: COST OF GOODS SOLD (SCHEDULE A)	1,420,378,309
3	GROSS PROFIT	702,302,674
4	DIVIDENDS (SCHEDULE C)	213,074,346
5	INTEREST ON OBLIGATIONS OF THE UNITED STATES	4,102
6	OTHER INTEREST	33,979,395
7	GROSS RENTS	409,933
8	GROSS ROYALTIES	20,655,069
9	(A) CAPITAL GAIN NET INCOME (SCHEDULE D)	249,208,276
	(B) NET GAIN OR (LOSS) FROM FORM 4797	528,511

(1120 Income Tax Return cont'd)

10	OTHER INCOME (ATTACH SCHEDULE)	14,801,703
11	TOTAL INCOME (ADD LINES 3 THROUGH 10)	1,234,964,009
12	COMPENSATION OF OFFICERS (SCHEDULE E)	5,952,114
13	SALARIES AND WAGES (NOT DEDUCTED ELSEWHERE)	132,877,205
14	REPAIRS	65,420,379
15	BAD DEBTS	4,308,240
16	RENTS	23,318,168
17	TAXES (ATTACH SCHEDULE)	76,710,850
18	INTEREST	64,146,345
19	CONTRIBUTIONS (ATTACH SCHEDULE)	649,602
20	AMORTIZATION	[Blank in Original]
21	DEPRECIATION FROM FORM 4562	61,037,062
22	DEPLETION	[Blank in Original]
23	ADVERTISING	11,635,752

(1120 Income Tax Return cont'd)

24	PENSION, PROFIT-SHARING PLANS (NO. OF PLANS)	91,174,682
25	EMPLOYEE BENEFIT PROGRAMS	64,948,432
26	OTHER DEDUCTIONS (ATTACH SCHEDULE)	98,004,609
27	TOTAL DEDUCTIONS (ADD LINES 12 THROUGH 26)	700,183,440
28	TAXABLE INCOME BEFORE NOLD [SIC] AND SPECIAL DEDUCTIONS	534,780,569
29	LESS: (A) NET OPERATING LOSS DEDUCTION	[Blank in Original]
	(B) SPECIAL DEDUCTIONS (SCHEDULE I)	199,145,924
30	TAXABLE INCOME (LINE 28 LESS LINE 29 (A) AND (B))	335,634,645

* * *

EXHIBIT B TO THE STIPULATION OF FACTS

Excerpts From the 1981 Annual Report of
The Bendix Corporation

[p.1]

FINANCIAL PROFILE

THE BENDIX CORPORATION AND CONSOLIDATED SUBSIDIARIES

For the Years Ended September 30	**1981**	**1980**	**Percent Change**
Net sales, royalties, and other operating income (in millions)	$4,425.4	$3,864.1	14.5%
Income from continuing operations (in millions)	204.5	134.2	52.4
Net income (in millions)	452.8	191.6	136.4
Income per share from continuing operations:			
A. Before major dispositions*	7.03	4.94	42.3
B. Total	8.35	5.38	55.2
Net income per share	18.49	7.68	140.8
Cash dividends per share	3.00	2.84	5.6

*UGC in 1981; Skagit in 1980. See "Discontinued Operations and Other Dispositions" on page 42.

* * *

[pp. 4-10]

CHAIRMAN'S MESSAGE

For the people of Bendix, 1981 was a year of fulfilled expectations and memorable results. Your company achieved record earnings while many businesses lost ground in a troubled economy.

Not only was it our eleventh consecutive year of earnings growth, but I am also pleased to report equally significant progress in our financial health and flexibility, in decentralization of our operations, in the strength of our management team, and in our technological capabilities. In short, our strategy of the last five years is working.

Your management believes that the results achieved in 1981 are in a real sense a tribute to the dedication and unsurpassed competence of Bendix people throughout the world. Their performance in an extremely challenging year has enhanced in every way our capacity to meet our ambitious aspirations for the future. We hope that this report will enable our shareholders to understand the year's results in the context of those aspirations and in the perspective of our management aims over the last several years.

Bendix' 1981 income from continuing operations increased by 52.4 percent, rising from $134.2 million in 1980 to $204.5 million in 1981. Moreover, our strategic restructuring of your company proved rewarding. It was reflected in an increase of net income from all sources of 136.4 percent—from $191.6 million to $452.8 million.

To bring 1981 results in
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- Up 55.2 percent fro
from continuing ope

- Up 140.8 percent fr
income from all sou

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mirror our intensified efforts
operations, elimination o
productivity, and improved
asset base.

This progress was by
began. We had chosen to try
goals simultaneously:

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- Restructure signifi
three major divestm

- Hold to our me
upgrading our tech
product programs.

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Any one of these objectives would have made 1981 an unusually challenging year for Bendix people. Yet by pushing energies to the limit and maintaining balance between conflicting demands, Bendix achieved excellent progress in all three areas.

All of our major businesses contributed handsomely to our earnings (see the table on page 35).

Although our Automotive Group no longer represents the dominant contributor to our earnings, it led the way in earnings improvement, recovering from its 1980 decline with a $57.4 million increase to produce income before taxes of $107.4 million. This was a notable achievement in a year in which domestic vehicle manufacturers experienced a severe slump. It reflected the underlying strength and diversity of our automotive operations.

Our Aerospace-Electronics Group reported record earnings of $105.5 million. We achieved our desired balance between short-term profits and expanded current expenses to finance programs for the future.

Our Industrial Group turned in $65.9 million in earnings from its activities. We continue to position ourselves and rationalize our actions in order to serve machine tool customers as a broad-based manufacturer.

Finally, our redeployment of assets through our divestment program also contributed significantly to net income in 1981. We completed our plan for major divestments with the sales of our forest products business, our interest in ASARCO Incorporated, and the stock of our subsidiary United Geophysical Corporation.

These major strategic actions converted approximately $500 million in lower-return assets into a liquid portfolio. We retained about the same book value of assets in the business, but dramatically increased their 1981 earning power by producing $65.6 million in portfolio income.

In addition, the effective execution of this asset redeployment program generated approximately $275 million in net gains from dispositions. These gains allowed the company to repurchase some four million shares of our own stock which should enhance future shareholder value.

While we tightened operations, we continued to expand expenditures in technology and engineering. Corporate-level commitments in technology were substantially increased as we outfitted and launched our new Advanced Technology Center in Columbia, Maryland and established five separate centers of technology expertise.

This year marked further strengthening of our management. We have promoted more than thirty of our outstanding operating and staff executives to the general manager level and above. We have also brought to Bendix new people who could contribute important insights, experience, and expertise. This effort also included the election to our Board of Directors of three individuals with outstanding credentials.

Thomas P. Stafford is perhaps best known as commander of Apollo 10 and of the Apollo-Soyuz joint U.S./Soviet space flight. General Stafford brings experience as a key project manager in a large organization as well as an understanding of advanced

technology and the teamwork necessary for its successful application.

William P. Tavoulareas, President of Mobil Corporation, adds to our Board his long experience in operating one of the largest diversified energy-based companies in the world.

Our third new board member is Bendix' new President, Alonzo L. McDonald, Jr., who served with distinction in key positions in the private sector and in the federal government. Al McDonald has already demonstrated at Bendix his ability to organize complex functions, marshal the best efforts of diverse staffs, help implement our strategies, and supplement our existing strengths.

Throughout the company, we pursued our decentralization philosophy. By realigning our primary operating responsibilities directly to our different businesses, we have unleashed a new force of management imagination and innovation. We continue to refine and improve decentralization in Bendix as we gain confidence and commitment for this concept of organization.

No year can stand alone regardless of the results produced. Its real significance—as in 1981—is best understood by viewing its place in a broader spectrum of time.

Your management is committed to consistent high performance and efficient utilization of its asset base. This commitment is reflected in the diversification of our earnings over the last five years. In 1977 about 61 percent of our earnings came from automotive operations.

Although that Group's earnings rebounded to lead the others in 1981, we have successfully shifted the corporate balance; only 28 percent of our record 1981 earnings came from the Automotive Group. The Aerospace-Electronics Group contribution to earnings kept pace with the Corporation's overall rate of growth. Earnings contributed by the Industrial Group increased significantly in this same five-year period from 11 percent to 17 percent. Another 17 percent of earnings was produced by our portfolio investments.

Thus, we have achieved less dependence on automotive operations while still expanding them, have maintained a solid rate of growth in our aerospace-electronics business, have built a major position in the industrial products markets, and have created a substantial investment portfolio.

Our growing emphasis on higher technology, including research, development, and engineering, is not new. We believe success in this area is a key to progress in this country and the rest of the free world. Our annual expenditures here have nearly doubled over the past five years. This steady trend reflects a determination to alter fundamentally the mix of our strengths, even during the difficult phases of business cycles.

Although economists forecast 1982 to be a difficult year, we anticipate continued progress at Bendix. We are, of course, subject to economic conditions, particularly in our Industrial Group, but we expect to exceed our 1981 operating record excluding gains from dispositions and discontinued operations.

Looking beyond next year, we are determined to reach still higher levels of excellence and sustained performance.

We have the capability to expand or restructure our businesses through acquisitions and other investments. A three-pronged acquisition program is well under way. The first concerns small new ventures that can open windows of opportunity for Bendix. We have made four such investments in 1981 and we anticipate continuing investments of this kind.

Second, we are considering natural extensions of our existing businesses which could improve our market position, increase our competitive effectiveness, and expand our longer-range potential. Resources will be available on a continuing basis to finance natural extensions of our existing businesses.

A third thrust is directed toward major businesses which could provide additional dimensions to the company. We are interested in sound values in areas in which our skills and market capabilities can be fully utilized. Since neither Bendix' future nor its earnings stability is dependent on making a near-term move, we are proceeding conservatively but persistently in this direction.

We have ended the year stronger than Bendix has ever been. Our assets are better structured to produce future earnings and to seek out new opportunities; our operations are more efficient; your management team is stronger; and our enthusiasm is high for the exciting tasks that lie ahead.

All of this has been achieved by Bendix people. Their solid efforts, their inspired performance, and the application of their special talents have become a Bendix hallmark—the power of ingenuity.

/s/ William M. Agee

WILLIAM M. AGEE
Chairman and Chief Executive Officer
December 9, 1981.

(Pictures, charts and graphs omitted in printing)

[p. 11]

THE BUSINESSES OF BENDIX

Bendix serves three major markets—aerospace-electronics, automotive, and industrial.

The Aerospace-Electronics Group provides products and services primarily for the commercial, military, and general aviation markets, and for other defense and space programs.

The Automotive Group supplies systems and components to domestic and foreign manufacturers of passenger cars, light trucks, and heavy vehicles, and also supplies a variety of replacement parts.

The Industrial Group supplies the metalworking industry with a wide range of machine tools and accessories and produces heavy-duty equipment and piping systems.

* * *

[p. 37]

FINANCIAL STATEMENTS

The Bendix Corporation and Consolidated Subsidiaries
CONSOLIDATED STATEMENT OF INCOME

For the Years Ended September 30(In millions, except share amounts)	1981	1980	1979
Income			
Net sales	$4,393.1	$3,837.6	$3,382.8
Royalties and other operating income	32.3	26.5	29.9
Miscellaneous income (deductions)—Net	209.0	30.7	(2.8)
Total	4,634.4	3,894.8	3,409.9
Deductions			
Cost of sales	3,509.0	3,033.2	2,681.9
Selling and administrative expenses	627.3	540.8	457.4
Interest expense	110.0	82.9	49.8
Minority interests	4.5	8.4	6.5
U.S. and foreign income taxes	179.1	95.3	95.0
Total	4,429.9	3,760.6	3,290.6

[p. 37 cont.]

Income from Continuing Operations	204.5	134.2	119.3
Income from discontinued operations, net of income taxes	248.3	57.4	43.3
Net Income	$ 452.8	$ 191.6	$ 162.6
Average Number of Common and Common Equivalent Shares Outstanding (in thousands)	24,482	24,952	22,904
Net Income Per Share			
Income from continuing operations	$ 8.35	$ 5.38	$ 5.21
Income from discontinued operations, net of income taxes	10.14	2.30	1.89
Net Income	$18.49	$ 7.68	$ 7.10
Cash Dividends Per Share	$ 3.00	$ 2.84	$ 2.56

See Notes to Consolidated Financial Statements which constitute an integral part of this statement.

[p. 38]

The Bendix Corporation and Consolidated Subsidiaries
CONSOLIDATED BALANCE SHEET

September 30 (in millions, except share amounts)	1981	1980
Assets		
Current Assets		
Cash and marketable securities	$ 572.2	$ 44.5
Trade receivables (less allowance for doubtful receivables)	622.0	648.2
Inventories and contracts in progress (less progress payments)	901.6	889.6
Prepaid expenses	86.0	70.5
Total Current Assets	2,181.8	1,652.8
Investments	98.3	33.6
Land, Buildings, and Equipment—Net	737.3	705.9
Goodwill and Other Intangibles (Less Amortization)	86.6	91.2
Net Assets of Discontinued Operations	[Blank in Original]	396.0
Miscellaneous Assets	114.5	44.0
Total	$3,218.5	$2,923.5

[p. 38 cont'd]

Liabilities and Stockholders' Equity		
Current Liabilities		
Notes payable	$ 103.7	$ 142.6
Accounts and drafts payable	370.5	411.0
U.S. and foreign income taxes	211.6	24.4
Other accrued liabilities	451.4	382.0
Total Current Liabilities	1,137.2	960.0
Long-Term Debt	519.6	549.4
Deferred Income Taxes	61.8	37.0
Minority Interests	33.0	36.3

[p.38 cont'd]

Stockholders' Equity		
Preferred Stock, no par (authorized, 7,000,000 shares, issuable in series)		
Series A $3 Cumulative Convertible (authorized, 400,000 shares of $7.50 stated value each; issued, 194,160 and 251,418 shares, respectively; liquidation preference, $10.3 million)	1.5	1.9
Series B 9-3/4% Cumulative Convertible (authorized, 4,600,000 shares of $41.50 stated and liquidation value each; issued, 4,115,023 and 4,068,695 shares, respectively)	170.8	168.9
Common Stock (authorized, 60,000,000 shares of $5 par value each; issued, 19,368,980 and 23,022,961 shares, respectively)	96.8	115.1
Additional Capital	42.7	46.7
Retained Earnings	1,158.9	1,012.0
Total	1,470.7	1,344.6

[p. 38 cont.]

Less—Cost of treasury stock (22,769 shares of Series A Preferred Stock and 83,487 shares of Common Stock)	3.8	3.8
Stockholders' Equity—Net	1,466.9	1,340.8
Total	$3,218.5	$2,923.5

See Notes to Consolidated Financial Statements which constitute an integral part of this statement.

* * *

EXHIBIT C TO THE STI
Excerpt from the 1979
The Bendix Co

[pp. 27 & 28]

FOREST PRO

The Eighties promise bo
opportunities for Bendix fore
prospects point to continuin
wood products—lumber, plyw
and particleboard—that B
Corporation (BFPC) turns out
300 million board feet annuall
and remodeling. But, because o
constraints on the nation's tim
for the future, according to
Guyol, is whether the supply w

BFPC is working coope
agencies and preservationist
supply-related issues. At the s
into business areas that ar
fluctuations than is the marke
Through two acquisitions—on
the other more recently—B
product lines and distribu
acquisition of Caradco, Bend
name products to its lines
windows and sliding patio do
are triple-glazed to answer
better insulation.

The recent addition of B
12 distribution centers in the s

ULATION FACTS
Annual Report of
rporation

DUCTS

h difficult challenges and
t products business. The
heavy demand for the
od, mouldings, millwork
ndix Forest Products
at the rate of more than
for new home building
increasing governmental
ber harvest, the question
BFPC President John T.
ll meet the need.

atively with government
groups to resolve these
me time, it is expanding
e less subject to price
for wood commodities.
completed in fiscal 1979,
FPC expanded both its
tion system. With its
x added quality brand-
aluminum-clad wood
rs, including some which
oday's requirements for

ss and Company, with its
utheastern United States,

gives Bendix a stronger position in the sale of specialty building materials. Bass distributes a large variety of products—including mouldings, stair parts, doors, windows, mantels, fireplaces and ceiling tile—to retail lumberyards and to home centers where the weekend handyman purchases his materials.

In addition to strengthening its base through these acquisitions, BFPC has implemented other strategies to assure its growth in the Eighties. It plans to greatly expand its network of distribution yards over the next five years and thus take its variety of products to a larger marketplace. And the subsidiary continues to concentrate its production on value-added products such as mouldings and millwork, which command a higher market price than the raw material from which they are made.

The strong position that these products give Bendix in the home remodeling market has significance for the short term in view of the projected downturn in new home construction. In 1979, housing starts declined from the 1978 level and current indicators—principally the rate of interest on new home mortgages—show clearly that the rate of new builds in 1980 will be substantially below the 1979 level.

While government monetary policy and the availability of mortgage and construction financing have a major impact on the homebuilding industry, and thus, on the demand for and price of wood commodities, another type of government involvement in the forest products business is even more serious.

About two-thirds of all timber in Western forests is government-owned. In recent years, more and more

federal timber has been withdrawn from the market, as vast tracts of National Forest land have been designated as wilderness areas or taken out of production for lengthy studies on how they ultimately should be used. As a result, forest products companies find themselves competing for a dwindling resource, and in some areas, find it uneconomical to operate. Such was the case at Johnsondale, California, where Bendix shut down a sawmill this year after 41 years of operation. The sawmill processed timber taken from a part of the forest where 300,000 acres were recently designated as a special wilderness area.

While this development had no significant effect on the earnings of the Corporation, it points to the need for a balance in the country's forest management policies that will allow society's need for wood products to be met in a manner that is consistent with sound conservation practices.

Bendix is a responsible voice in promoting policies which would allow forests to be devoted to multiple use. Bendix operates on the principle of long-term sustained yield which provides that trees could be harvested perpetually at a rate not exceeding that at which they reproduce. Wood is, after all, a renewable resource. And Bendix this year planted 300,000 seedlings on its own lands to assure the cycle will continue uninterrupted so that fifty and one hundred years from now, trees will be maturing for harvest.

Summary

Bendix Forest Products Corporation provides construction lumber, remanufactured wood products and

other materials to the home building and remodeling, industrial and agricultural markets.

BFPC's products include lumber, plywood, particleboard, mouldings, millwork, unfinished furniture, fencing, wooden containers, aluminum siding and accessories, and wood windows and patio doors.

(Pictures and graphs omitted in printing)

EXHIBIT D TO THE STIPULATION OF FACTS

From the desk of
R.O. BRADLEY

April 7, 1977

TO: W. M. Agee

Jerry Jacobson asked me to send you the attached Value Line and Moody's write-ups on a sampling of natural resources companies. They were selected to provide a basis for thinking about a Bendix involvement in this area.

Rosetta Riley's summary highlights some of the factors to be considered, and the individual summaries highlight some of the advantages and disadvantages to be dealt with.

Going ahead, we will be evaluating an involvement on three bases: a letter stock portfolio approach, acquisition of a modest size company, and merger with one of the more sizable companies.

ROB/br

cc: J. Jacobson
M. Lord
R. Riley
P. Wood

EXECUTIVE SUMMARY

The objective of this exercise was to draw up a list of companies primarily engaged in the production, development and exploration of natural resources. We selected seven companies which we felt were most typical. The companies vary in size as well as type of products manufactured, including Industrial Gases/Fertilizer, Coal and Uranium, Metals & Mining, and Lead, Zinc and Minor Metals.

The following table shows their key characteristics.

Rank	Companies	Sales $M	Net Income $M	Net Worth $M	% Earned on Book Net Worth	% Earned on Market Net Worth	Income Tax Rate	Debt Ratio, 1975 %
1	Gulf Resources & Chemical Corp.	370	27.0	175.0	15.5	15.5	43.0	46.0
2	North American Coal Co.	290	7.0	57.0	16.0	9.0	26.0	79.0
3	Westmoreland Coal Co.	410	37.5	215.0	18.0	11.0	32.0	0.0
4	Newmont Mining Co.	675	85.0	710.0	12.0	12.0	30.0	32.0
5	St. Joe Minerals	880	86.0	455.0	19.0	9.6	35.0	8.7
6	Williams Companies	1200	80.0	730.0	11.0	12.7	32.0	50.0
7	Hanna Mining Co.	400	66.8	386	16.5	12.5	40.0	44.0

We observed that companies classified in the natural resources industry regardless of size and their principal product lines tend to have certain characteristics in

common. Some of the simmilarities [sic] among these companies that impressed us are noted below:

- They tend to be countercyclical to movements in the overall economy, (GNP).

- Income tax rates tend to fall within a range of 30-35%, thereby implying some risk if their tax depletion allowances are ended.

- Whereas these types of companies may offer Bendix an opportunity for diversifying, there is some question as to what Bendix would offer such a company. Of course, to small companies we offer pecuniary benefits and economies of scale, but for larger companies, the advantages of merger with Bendix are somewhat speculative. Perhaps they need the cash flow we could offer.

- All the companies tend to have good to strong reserves of resources.

- Earnings are good, and stable.

- Many of the companies have a very low asset turnover, as low as one or less in some cases. Debt ratios tend to be high—above the Bendix 35% level.

R. Riley
4/7/77

EXHIBIT I TO THE STIPULATION OF FACTS

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation held on October 26, 1978

[p. 9]

STATUS OF INVESTMENT IN ASARCO

Mr. Agee reported on and the Board discussed the memorandum entitled "Status of Investment in ASARCO", a copy of which had been sent to each director prior to the meeting. A copy of the memorandum, initialed by the Secretary, is filed with the records of the meeting.

There being no further business, the meeting was adjourned.

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Secretary

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date October 26 1978 Letter No.

To Board of Directors

From W. M. Agee

Subject Status of Investment in ASARCO

In April, the Board authorized an investment of up to 21% of ASARCO common stock at a cost not to exceed $134 million. As discussed at our last meeting, it is our intention to provide a status report on this investment at all future meetings.

As of this date, we hold about 19.6% of ASARCO common stock at a total cost of $125.6 million. In addition, we have an option remaining to acquire 126,200 shares from Crane Co. at $16.50 per share. Exercise of this option would bring our total holdings to just under 20% at a total cost of $127.7 million.

Although ASARCO had earned $4.66 per share as recently as 1974, it concluded 1977 at a $1.10 per share loss, only the second loss in its 78 year history. During the time span since 1974 the industry has been caught up in a worldwide recession, an overhang of worldwide supply, and major new environmental costs. Moreover, for ASARCO, the period has also been punctuated with costly strikes and the permanent closure of a number of its productive facilities. A backdrop and aggravating factor to all this has been an emergence of copper supplies in underdeveloped countries where production

and pricing policies do not follow the usual economic decision patterns for this industry.

The adverse trends experienced by ASARCO in 1977 continued into its first quarter of 1978, resulting in a loss of 42¢ per share compared to a 30¢ per share profit in the same period of 1977. At 11¢ per share profit, the second quarter was somewhat better than the first due principally to a modest improvement in copper prices coupled with a cessation of strikes which had impacted the earlier quarter. Pricing during this quarter, however, remained unfavorable to the year earlier comparable quarter in which the Company earned 56¢ per share.

Since the second quarter, copper prices have continued to firm both in the spot and forward markets. If, as many believe, this is the beginning of a longer term pricing trend, the first half loss should be somewhat more than offset over the balance of 1978, and 1979 should pull solidly into the black.

Our decision to invest in ASARCO was grounded in the belief that the removal of the stockpile overhang by increasing world-wide demand should make this a very profitable business by the early to mid-'80s, given the extremely high cost and long lead times involved in bringing new productive capacity on stream. Also, fundamental to our decision was the fact that while current replacement values of the productive capacity of ASARCO is [sic] about twice book values, we were able to acquire our investment at something around 2/3 of the ASARCO book value.

Other than pricing and market conditions, coping with the various environmental regulations continues to occupy the highest priority of management and financial

resources for ASARCO and the industry as a whole. For example, the industry has indicated that recently imposed EPA regulations concerning ambient air lead tolerances in the manufacturing facilities will essentially close down the industry unless modified in final implementation. It is expected that a compromise will be struck in lieu of this drastic result since no one in the industry appears to be substantially ahead in the state of the art.

To date, we have been accounting for our investment following the cost method, under which only dividends from ASARCO are reflected in income. At the present rate per share, the dividends contribute about 10¢ per Bendix share towards the 25¢ per share annual interest carrying cost of the investment.

At such time that our ownership percentage exceeds 20%, we will most likely account for our investment under the so-called equity method. Under this method, Bendix will include in income its proportionate share of the income or loss of ASARCO, as well as the amortization of the difference between the cost and the underlying book value of its investment, or "negative goodwill". As can be seen from the attached table, the negative goodwill amortization amounts to about 25¢ per Bendix share regardless of ASARCO income. For example, if ASARCO were to earn $2.00 per share, the Bendix per share earnings would include about 40¢ for its portion. This, together with the negative goodwill amortization of 25¢ would mean that the ASARCO investment would contribute about 40¢ per share to the bottom line of Bendix after covering the 25¢ interest carrying cost of the investment. While these numbers are illustrative only, they are reflective of the kind of numbers that we would expect to see, given a continuation of the moderately

improving price trend that has taken place over the last few months.

(Attachment omitted in printing)

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation Held on February 22, 1979

[p. 4]

FINANCIAL REPORT

Mr. Svec reviewed the financial statements which had been sent to each director prior to the meeting, copies of which, initialed by the Secretary, are filed with the records of the meeting. He reported on the Corporation's annual financial plan as adjusted for ASARCO equity accounting, the adoption of LIFO for the domestic automotive operations and on various other financial matters. Mr. Svec also reviewed, and the Board discussed, the memorandum entitled "Status of Investment in ASARCO", a copy of which had been sent to each director prior to the meeting. A copy of the memorandum, initialed by the Secretary is filed with the records of the meeting.

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date February 12, 1979 Letter No.

To Board of Directors

From W. M. Agee

Subject Status of Investment in Asarco

Since our October 26, 1978 status report to the Board, we have purchased 135,000 additional shares of Asarco at a cost of $2.0 million. We currently hold, at a total cost of $127.6 million, 6.1 million shares, or 20.01% of Asarco's outstanding common shares. We elected not to exercise the remaining option to acquire 126,200 shares from Crane Company because a more favorable price was available on the open market.

As you know, we have adopted the equity method of accounting for this investment effective October 1, 1978. Briefly, the equity method means that Bendix will include in income its proportionate share of the income or loss of Asarco, as well as amortization of the difference between cost and the underlying book value of its investment ("negative goodwill").

As can be seen from the attached table, Asarco's contribution to our first quarter EPS was about two cents a share, after taking interest cost of approximately seven cents a share into account. "Cash earnings", representing Asarco dividends received less income taxes payable, were about two and a half cents a share before interest

costs. Because we report Asarc
these results reflect Asarco's Se

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The trend toward higher demand for U.S. produced copper is at least in part the result of U.S. producers adopting a more competitive pricing system, which has greatly reduced foreign imports. In fact, the U.S. is now a net exporter of copper. Also, almost every major foreign copper producing country is having difficulty with both volume and quality of production as a result of political turmoil. For these reasons, as well as the possibility of China becoming a major new market for copper, the prospects for copper producers in the 1980's look significantly more favorable than at the time of our investment decision.

(Attachments omitted in printing)

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation Held on April 26, 1979

[p. 5]

FINANCIAL REPORT

F. J. Svec reviewed, and the Board discussed, the financial information which had been sent to each of the directors prior to the meeting, a copy of which, initialed by the Secretary, is filed with the records of the meeting. He reported on the impact of ASARCO equity accounting, and on the Corporation's cash flow, debt/equity ratio, inventory and receivable turnover ratios, capital expenditures and various other financial matters.

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date April 26, 1979

To Board of Directors

From W. M. Agee

Subject Status of Investment in Asarco

Asarco closed out 1978 on the upswing—with rising prices for nonferrous metals that reflect the improved supply/demand trends evident since we acquired our ownership interest. Closing prices for copper, lead, silver and zinc were considerably higher than those at the beginning of 1978.

Asarco's greatly improved fourth (our second) quarter results are reflected in the attached table. The outlook for Bendix' third and fourth quarters is based on Asarco's 1979 forecast, which is very conservative in view of present metals price trends. February prices reflect increases of 23% for copper, 19% for silver, 19% for lead, and 3% for zinc over average prices used in the forecast.

Asarco's priorities for use of its greatly increased earnings, as indicated in a recent news release, are to increase dividends and reduce debt. A review of the current dividend (of ten cents per quarter) is scheduled for Asarco's April Board of Directors meeting.

All of the foregoing continue to support positively the prospects for our investment in Asarco.

Attachment (Attachment omitted in printing)

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation Held on June 18, 1979

[p. 7]

STATUS OF INVESTMENT IN ASARCO

Mr. Agee noted that a memorandum entitled "Asarco Status Report" had been sent to each director prior to the meeting. A copy of the memorandum, initialed by the Secretary, is filed with the records of the meeting.

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date June 18, 1979 Letter No.

To Board of Directors

From W. M. Agee

Subject Asarco Status Report

The attached table reflects the current fiscal 1979 outlook for Bendix' equity in Asarco earnings. The outlook reflects nine months of actual results (through March 31) and Asarco's current forecast for its second (our fourth) quarter ending June 30.

The Asarco quarterly dividend increase to 20 cents a share raises "cash earnings" (dividends after tax) from Asarco to an annual level of 20 cents per Bendix share. This compares to Bendix' after tax interest cost of 29 cents a share. The dividend increase and a $100 million reduction in long-term debt since March 31, 1978 are in line with stated Asarco financial priorities discussed in the April 26, 1979 status report.

While there has been some softening of the copper price since it peaked at over $1.00 a pound, the present upper 80 cent range is still slightly higher than the 85 cent price assumed in Asarco's current forecast. Recent declines in copper prices can be attributed to profit taking by metals brokers. Our favorable assessment of copper supply and demand fundamentals remains unchanged. Inventory levels and generally strengthening economies in Europe and Japan lead Asarco to believe, even if U.S. business

conditions flatten, that worldwide markets will not repeat the sharp downturn that occurred in 1974.

Silver and lead prices are now at a much higher level than used in Asarco's forecast. Silver price increases are in response to renewed interest in silver as a hedge against inflation, while lead price increases are due to increased worldwide demand (principally from communist bloc countries) and domestic mine strikes. U.S. producers, hampered by an earlier ruling that lead and zinc prices were not exempt from "voluntary" price guidelines, were experiencing difficulty obtaining sufficient supplies of lead concentrate at a price which would permit adequate margins for their refinery operations. However, U.S. producers, stating that lead should be exempted from the guidelines since it is an international commodity, recently raised prices to be more in line with world price levels.

Attachment (Attachment omitted in printing)

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation Held on October 25, 1979

[p. 3]

PRESENTATION OF FISCAL 1980 ANNUAL FINANCIAL PLAN

F. J. Svec then presented the Corporation's fiscal 1980 annual financial plan, utilizing various slides. A copy of such slides, initialed by the Secretary, is filed with records of the meeting. Mr. Agee then commented on the outlook for the Corporation for fiscal 1980 and the status of the Corporation's investment in ASARCO. A communication dated October 25, 1979 from W. M. Agee on the latter subject had been sent to each of the directors prior to the meeting. A copy of the communication, initialed by the Secretary, is filed with the records of the meeting.

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date October 25, 1979 Letter No.

To Board of Directors

From W. M. Agee

Subject Status of Investment in Asarco

Attached is a table which shows Bendix' equity in Asarco earnings for fiscal 1979 and the equity in earnings included in the fiscal 1980 Annual Financial Plan (AFP). As the table indicates, our equity in the income of Asarco made an important contribution to fiscal 1979 EPS of $1.11, less interest costs of approximately $.29. Based on Asarco's earnings projections, this investment will contribute a $.46 per share favorable variance to Bendix' earnings trend for fiscal 1980, with equity income of $1.57, less interest costs of $.29.

Price trends during calendar 1979 for silver, copper, lead and zinc are shown in the attached graphs. The surge in silver, copper and lead prices is due, in part, to the market fundamentals which prompted our investment in Asarco. A much more significant factor, however, with respect to the dramatic rise in silver and copper prices has been strong recent interest in those metals as inflation hedges.

Also shown on the graphs are the metal prices assumed in the 1980 Asarco outlook upon which our 1980 AFP was based. A continuation of metals prices at or near their

current levels could generate a substantial favorable variance from the AFP earnings level.

Asarco's Board of Directors, on July 25, 1979, approved the repurchase on the open market of up to 1,000,000 shares of Asarco's stock. The repurchase program will result in a modest increase in Bendix' ownership percentage.

(Attachments omitted in printing)

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation Held on January 31, 1980

[p. 6]

FINANCIAL REPORT

Mr. Svec reviewed the financial statements which had been sent to each director prior to the meeting, copies of which, initialed by the Secretary, are filed with the records of the meeting. Mr. Svec also commented on the recent currency devaluation in Brazil, indicating its impact on the Corporation. He also reviewed, and the Board discussed, the Corporation's cash flow, inventories and receivables turnover, capital expenditures and various other financial matters including the Corporation's equity investment in ASARCO and the memorandum entitled "Status of Investment in ASARCO", a copy of which had been sent to each director prior to the meeting. A copy of the memorandum, initialed by the Secretary, is filed with the records of the meeting.

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date January 31, 1980 Letter No.

To Board of Directors

From W. M. Agee

Subject Status of Investment in Asarco

The attached table shows the 1980 outlook for Bendix' equity in earnings of Asarco. As the table indicates, based on Asarco forecasts, Asarco is projected to contribute an $.88 per share favorable variance to Bendix' 1979 earnings, of which $.75 per share is expected to occur in the first two quarters. The current outlook also reflects a $.42 per share improvement over the 1980 Annual Financial Plan (AFP).

The favorable variance from 1979 results is primarily due to higher silver, copper and molybdenum prices. In fact, if other operations were to hold as forecasted and silver and copper prices remained at the year end prices indicated on the attached chart, we could expect equity in earnings of Asarco to contribute approximately an additional $1.10 a share over the next twelve months, or an additional $.55 per share over the present fiscal 1980 outlook. It is well known, of course, that speculative interest is driving current silver and copper prices even above those in the chart. It is difficult, however, to assess the length of time this influence will be felt. Nevertheless, we believe the basic supply and demand relationships for

both metals are such that present forecast levels are very conservative.

(Attachments omitted in printing)

Excerpts from the Records of
Directors of The Bendix
April 24

[p. 23]

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Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date April 24, 1980 Letter No.

To Board of Directors

From W. M. Agee

Subject Status of Investment in Asarco

The attached table shows the current 1980 outlook for Bendix' equity in earnings of Asarco, based on actual results through the first two months of Asarco's first (our third) quarter and Asarco forecasts for the remainder of the year. The Asarco contribution to Bendix fiscal 1980 earnings per share is expected to be $2.55 (before the effect of preferred stock issued in the Warner & Swasey acquisition), a $1.44 increase over the contribution to Bendix' 1979 earnings.

The speculative interest which had been driving silver and copper prices evaporated in dramatic and widely publicized fashion during late March. Nevertheless, copper and silver prices have fallen only slightly below the levels used in Asarco's forecast and therefore should not result in a significant unfavorable variance from the current outlook for Bendix' third and fourth quarters. In addition, as the June 30 expiration date for labor contracts at Asarco's principal domestic mines approaches, prices may be favorably impacted by advance buying in anticipation of a possible strike.

Actual and forecast prices are indicated in the attached chart. Current prices for most nonferrous metals are

believed by Asarco to be in line with supply and demand fundamentals for these markets.

Asarco also recently announced Board of Directors authorization for the repurchase of up to 500,000 shares of its common stock. If the entire authorized amount were repurchased, Bendix' ownership percentage would increase from approximately 20.7 to 21 percent and equity in Asarco earnings would be modestly improved (about $.01 per share for fiscal 1980).

Attachments (Attachments omitted in printing)

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation held on June 26, 1980

[p. 19]

STATUS OF INVESTMENT IN ASARCO

Mr. Agee noted that a memorandum entitled "Status of Investment in ASARCO" had been sent to each director prior to the meeting. A copy of the memorandum, initialed by the Secretary, is filed with the records of the meeting.

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date June 26, 1980 Letter No.

To Board of Directors

From W. M. Agee

Subject Status of Investment in Asarco

The current 1980 outlook for Bendix' equity in earnings of Asarco, based on actual results through Asarco's first (our third) quarter and Asarco forecasts for the rest of the year is reflected in the attached table. The expected Asarco contribution to Bendix' fiscal 1980 earnings per share of $2.50 is a $1.39 increase over the contribution to Bendix' 1979 earnings. It is, however, a $.05 decrease from the previous estimate given to the Board, reflecting some softness in demand for copper and lead as a result of economic conditions in the domestic automotive and housing industries.

Not reflected in the current outlook are the estimated effects of several accounting and other matters currently being finalized by Asarco which could further reduce the expected Asarco contribution to Bendix' EPS by about 13 cents. Based on a review of actual and forecast metals prices for Asarco's second (our fourth) quarter (reflected in the attached chart), we do not anticipate any further significant variance from the current 1980 outlook. The recent increase in silver prices to the $15-$18 per ounce

range should offset much of the softening in other metals prices (particularly lead).

Attachment (Attachment omitted in printing)

Excerpts from the Records of the Meeting of the Board of Directors of The Bendix Corporation held on August 28, 1980

[p.4]

W. M. Agee reported on the outlook for Asarco Incorporated. He referred to a communication dated August 28, 1980 entitled "Status of Investment in Asarco", a copy of which had been sent to each director prior to the meeting. A copy of the communication, initialed by the Secretary, is filed with the records of the meeting.

Internal
Memorandum

Bendix
Executive Offices
Southfield, Michigan

Date August 28, 1980 Letter No.

To Board of Directors

From W. M. Agee

Subject Status of Investment in Asarco

The current 1980 outlook for Bendix' equity in Asarco earnings reflected in the attached is based on twelve month results through June 30, 1980. The expected contribution to fiscal 1980 earnings per share of $2.22 is a $1.11 increase over the contribution to fiscal 1979 earnings per share. As we had anticipated at the time of our last status report, this increase is approximately $.12 per share less than the previous formal estimate to the Board, because of required adjustments to provisional sales recognized in earlier periods at the higher prices then prevailing and other operating factors.

Also attached is a chart of forecasted and actual (through July 31) metals prices for Asarco. Because of the strike within the copper industry, current metals prices are not a reliable indicator of the level or trend of future Asarco earnings. Although the strike will have a substantial adverse affect on Asarco's domestic operating results, the impact on consolidated results should be softened somewhat by operations in other countries. The severity of the impact on Asarco earnings will in large measure be determined by the length of the strike, as well

as the timing and strength of the recovery in the housing and automotive industries from the current recession.

Attachment (Attachment omitted in printing)

EXHIBIT U TO THE STIPULATION OF FACTS

August 24, 1982

To: Board of Directors

From: W. M. Agee

Subject: Acquisition of GEORGIA

Management requests authority to pursue the acquisition of GEORGIA. Management believes the combination would benefit the shareholders of both companies and would constitute a strong, well-balanced company.

Proposal

We propose that Bendix make a cash offer to buy up to 50% of GEORGIA's common shares for $40 per share. It is contemplated that following the acquisition Bendix would propose the acquisition of the balance of GEORGIA's common stock through a merger or exchange offer, which we intend be tax free, in an exchange of Bendix common stock for GEORGIA shares. The tender offer will set forth an intended exchange ratio for this second step based upon the current relationship of the tender offer price and the market price ($50) of Bendix common stock (*e.g.*, .8 of a share of Bendix stock for each share of GEORGIA), and will explain that Bendix reserves the right to revise the ratio, the consideration or the terms generally as circumstances change.

Upon authorization, management would alert GEORGIA management to the Bendix offer and indicate our strong preference for a friendly transaction.

Background on GEORGIA

The following background is derived from publicly available information.

GEORGIA is a diversified producer with 1981 sales of $3.3 billion, serving the aerospace and primary materials (aluminum, cement, aggregates and chemical) markets. It was formed in 1961 by merger of predecessor companies. From 1968 through 1974, it acquired portions of Harvey Aluminum, now GEORGIA Aluminum, Inc.

The bulk of GEORGIA's sales and profits are in fast-growing, profitable aerospace businesses. In contrast to our Aerospace Group which is primarily a subcontractor, GEORGIA is primarily a prime contractor; GEORGIA is primarily engaged in missiles, we are primarily in aircraft. The balance of GEORGIA's businesses are in cyclical primary materials (aluminum, cement, aggregates and chemicals) which have recently been depressed because of the general state of the economy and high interest rates.

Aerospace—Most of GEORGIA's sales (58.4% in 1981) are aerospace related. The aerospace segment designs, develops and produces missile systems, space systems, launch vehicles, weapons systems, electronic and communications systems and aircraft components. Approximately 90% of this segment's sales are to the U.S. Government. Major contracts include the Pershing surface-to-surface missile system, the MX missile, the Titan III, the Space Shuttle's external fuel tanks, and the fire control system for the F-18 fighter. Most of these contracts are in the early stages of their life, with excellent prospects for growth and profitability. The aerospace segment produced an operating profit in 1981 of $136.5

million, and has continued to improve in the first half of 1982 at a record pace. Approximately 80% of aerospace revenues are derived from cost-reimbursement contracts.

Aluminum—The company's next largest segment (15.8% in 1981) is aluminum production. GEORGIA is an integrated producer, from bauxite mining, alumina production, aluminum reduction, through milling. It is further integrated in a limited way through extrusion and fabrication. This segment also produces titanium products and calcined petroleum coke, and it manages on a fee basis the operation of a Government ordnance plant. Because of the current depressed market for aluminum products and high interest costs resulting from extensive plant reburbishings, the aluminum segment is operating at a loss. The company's two reduction plants have recently been modernized, and an alumina plant in St. Croix is being expanded. The segment is about one-fifth to one-fourth the size of the major integrated producers such as Alcoa, Alcan, Reynolds and Kaiser. A return to acceptable levels of profitability could not be expected before a general economic recovery, but relatively little additional capital expenditure is required to prepare for the next upswing.

Chemicals—The chemical segment produces concrete admixtures, grouting compounds, floor hardeners, surfacing materials, organic dyes, and chemical magnesia. The company is the leading producer of sulfur dyes and is a major producer of textile dyestuff. The segment has continued profitability despite the current economic downturn.

Concrete and Aggregates—These two segments produce cement, stone, sand, and gravel primarily for the construction industry. Other specialty products include

lime, agricultural limestone, and chemical grade silica sand. These segments are multi-plant and regional in nature. While these segments were profitable in the second quarter of 1982, they remain at depressed levels because of low activity in the construction industry.

Other—The company also provides data processing services to private industry and to the U.S. Government. It also develops real estate and participates in various joint ventures, including a Suzozite Mica mine in Canada.

Financials—GEORGIA is a financially strong company. However, the continuing depressed economic climate and recent heavy capital expenditures have caused GEORGIA to increase its debt ratio from 13% at 12/31/80 to 30% at 6/30/82. The company's sales and earnings in the last several years are as follows:

GEORGIA Sales and Earnings
(In Millions of Dollars)

					1982	
	1978	1979	1980	1981	1st half	2nd Quarter
Sales	1,758	2,061	2,619	3,294	1,732	910
Earnings (net)	136	178	188	200	56	40

Shareholders—GEORGIA has approximately 35.6 million shares outstanding. About 1.6% of shares are owned by corporate insiders, about 7.2% by investment companies, and approximately 43.0% are owned by major institutional holders. About 4.5% is owned as an

investment by Bendix, under a portfolio investment program previously authorized by the Board. (This investment position has not been disclosed publicly by Bendix). The remaining 43.7% are held by the general public or other non-reporting entities.

The Combination

The combined company would be a stable, financially strong, diversified manufacturing company, predominantly engaged in aerospace/electronics activities. Approximately four-fifths of aerospace sales would be directed toward the military, and one-fifth would be to commercial and general aviation customers. About one-fourth of the combined company's sales would be to the automotive market, about one-tenth to the industrial machinery market, and approximately one-seventh in primary materials production (aluminum, cement, aggregates, and chemicals).

TABLE
Combined Sales
(Bendix and GEORGIA 1981 fiscal years)
(in millions)

Sales by Segment	Amount	% of Total
Aerospace/Electronics	$3,392.6	43.9%
Aluminum Processing	522.2	6.8
Automotive	2,176.5	28.2
Cement and Aggregates	371.6	4.8
Chemicals	276.5	3.6
Industrial	784.9	10.2
Other Operations and Intercompany Eliminations	195.2	2.5
Total	$7,719.5	100.0%

We believe that the management approaches Bendix now employs are well suited to GEORGIA's businesses. We are confident that Bendix' commitment to technological advancement, quality products and services, a stimulating work environment, and high returns are compatible with GEORGIA management and employees. In addition, our commitment to the aerospace industry would be deepened, strengthening our reputation as a reliable supplier to this nation's defense and that of its allies. Bendix' exposure to the automotive market would be reduced, while our participation in reindustrialization and the rebuilding of the country's infrastructure would be enhanced.

The combined company would be stronger financially, with about double Bendix' current profits and assets. It would have a richer technological content and a newer asset base. The disciplines in our design and manufacturing activities are complementary overall and very similar in the aerospace/electronics areas.

The acquisition could expose Bendix to greater operating risks, although these are considered to be manageable. One risk is that the aluminum industry could remain depressed for several more years, thereby lagging in repayment of the substantial recent investments that have been made in modernized plants. Another is that interest rates could rise to new heights, further dampening demand and putting pressure on interest coverage ratios. We believe the combined financial strength of the merged entity could withstand these risks better than most major U.S. corporations.

Shareholder Effects

Bendix' shareholders would benefit from the combination as participants in a larger, more profitable, and more diversified company with predominant sales in aerospace and higher technology activities. We do not anticipate any appreciable dilution in earnings per share would result for either company.

GEORGIA's shareholders would fare very well. For those who received cash, there would be a substantial premium over recent market prices. The share price of GEORGIA stock has been as low as $22.25 in recent weeks, and it closed at $30-5/8 yesterday, August 23. The $40 offer represents approximately $11.50 per share on an average more than GEORGIA paid to repurchase some 700,000 of its own shares earlier this year. Those who received Bendix stock, assuming an .8 to 1 exchange ratio based upon the tender offer price and Bendix' recent market price, would realize substantial increase on earnings per share, and a 39% higher dividend. GEORGIA shareholders would be well represented in the new combined company, owning in excess of 40% of the common stock.

The Approach

We would intend to propose to GEORGIA management that they accept the Bendix offer on a friendly basis. Nevertheless, the GEORGIA board and management may well resist our offer. Our investment banking advisor, Salomon Brothers, believes there is a good chance such an offer will succeed on purely economic grounds and has advised us that the terms of our offer are fair to Bendix.

If a second request for information is received, clearance of our Hart-Scott antitrust filing could take approximately one month. Jerry Shapiro of Hughes Hubbard & Reed will be at the meeting to discuss his firm's antitrust conclusions with you.

Once the transaction is complete, we will have a higher proportion of short- and medium-term debt. We continue to plan to prepare new long-term debt financing when attractive rates are available. However, immediate financing of this kind is not necessary to the success of this transaction.

The transaction would be funded with some of our existing cash and investments, revolving credit agreements and new lines of credit. These sources are sufficient without liquidating our investment position in RCA. Our resulting debt ratio would be within our existing loan covenants, and we believe would allow us to retain our existing credit agency ratings.

Request for Authority

Management requests authority to make an offer as outlined above for the common shares of GEORGIA at the timing within the next ninety days as it deems appropriate, and to take all appropriate actions including effecting additional borrowings and regulatory filings required to complete this acquisition.

SUMMARY

	EARNINGS				DEBT RATIO			INTEREST COVERAGE		
	1982	1983	1984	1985	1983	1984	1985	1983	1984	1985
STAND ALONE										
EARTH	5.87	6.11	8.70	11.05	26.8	26.3	24.6	3.43	4.32	4.98
GEORGIA	3.38	4.25	5.99	7.51	29.7	–	–	3.94	–	–
VALUATIONS										
Base: $40/share; 50% Cash		6.14	9.22	12.19	38.5	37.7	34.1	2.51		
• Increase Income $25MM/yr		6.82	9.93	12.94	38.3	37.1	33.1	2.77		
• Reduce Cash to 45%		6.08	9.05	11.92	36.6	35.8	32.2	2.66	3.46	4.40
• Change Interest to 14 1/2%		6.24	9.34	12.30	38.5	37.6	34.0	2.59		
• $5.00 Drop in Earth Price		5.89	8.84	11.69	38.6	37.8	34.2	2.51		
Increase Price to $45.00										
50% Cash		5.38	8.33	11.16	39.1	38.4	35.0	2.31		
• Increase Income $25MM/yr		6.03	9.01	11.88	38.8	37.8	34.0	2.57		
• Reduce Cash to 45%		5.35	8.18	10.91	37.0	36.3	33.0	2.45	3.23	4.12
• Change Interest to 14 1/2%		5.50	8.46	11.29	39.0	38.3	34.9	2.39		
• $5.00 Drop in Earth Price		5.15	7.96	10.67	39.1	38.4	35.1	2.31		

TAX COURT OF NEW JERSEY

Docket No. 14-24-0504-84-CB
CIVIL ACTION

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BENDIX CORPORATION,
Plaintiff,

v.

DIRECTOR, DIVISION OF
TAXATION,
Defendant.

Order Admitting
Report of
Defendant's
Expert

This matter having been opened to the Court by Riker, Danzig, Scherer, Hyland & Perretti, attorneys for plaintiff, on plaintiff's motion to exclude the report of defendant's expert, and the defendant having filed an opposing brief, the Court having reviewed the briefs, expert's report and accompanying documents, having heard argument, and for good cause shown,

IT IS on this 7th day of December, 1987,

ORDERED that plaintiff's motion is denied and the report of defendant's expert, Professor Harbir Singh, is hereby admitted as part of the record in this case.

/s/ Lawrence L. Lasser
Lawrence L. Lasser, P.J.T.C.

PAPERS CONSIDERED:

_____Notice of Motion

_____Movant's Affidavits

_____Movant's Brief

_____Answering Affidavits

_____Answering Brief

_____Cross-Motion

_____Other_____

Supreme Court, U.S.
FILED
JAN 10 1992
OFFICE OF THE CLERK

No. 91-615

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF PETITIONER

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PETITION FOR CERTIORARI FILED OCTOBER 11, 1991
CERTIORARI GRANTED NOVEMBER 27, 1991

QUESTIONS PRESENTED

1. Whether the Due Process and Commerce Clauses preclude a state from imposing a tax on income that a nondomiciliary corporation derives from the sale of its minority interest in another corporation, when the two corporations are not engaged in a unitary business and when the only connection between the taxpayer's minority investment and the taxing state lies in the taxpayer's subsequent use of the proceeds from the sale of its investment.

2. Whether this Court should now clarify, or should additionally articulate, the criteria it has set forth in *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and related cases, so as to forestall the widespread efforts of states to extend their taxing power well beyond traditional constitutional confines by taxing intangible income with which they have no substantial connection.

LIST OF PARTIES

The parties are as stated in the caption. In the courts below, the taxpayer was referred to as The Bendix Corporation. As appears in the Rule 29.1 Statement, Allied-Signal Inc. has become the successor-in-interest to The Bendix Corporation by successive mergers.

RULE 29.1 STATEMENT

Pursuant to Rule 29.1 of the Rules of this Court, petitioner states that prior to January 31, 1983, The Bendix Corporation had no parent corporation. On January 31, 1983, The Bendix Corporation became a wholly-owned subsidiary of Allied Corporation, which then had no parent corporation. On March 31, 1985, The Bendix Corporation was merged into Allied Corporation. Subsequent to March 31, 1985, and prior to September 30, 1987, Allied Corporation was a wholly-owned subsidiary of The Signal Companies, Inc., which in turn was a wholly-owned subsidiary of Allied-Signal Inc. On September 30, 1987, both of these companies were merged into the parent company, Allied-Signal Inc. Allied-Signal Inc. has no parent corporation. Its non-wholly-owned subsidiaries are listed in Appendix E to the Petition for Certiorari at 72a and, except for the addition of Universal Assets Inc., there are no subsequent changes to the list.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES vi

OPINIONS BELOW 1

JURISDICTION 2

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 2

STATEMENT 2

1. Bendix's Business 3

2. Bendix's Corporate Strategies and Its History of Selective Acquisitions and Divestitures 4

3. Bendix's Purchase and Sale of Its Minority Interest in ASARCO 5

   a. Bendix's acquisition of a 20.6 percent investment in ASARCO 5

   b. The relationship between Bendix and ASARCO 7

   c. Bendix's sale of its minority interest in ASARCO 10

4. The Tax Assessment 10

5. The Proceedings Below 11

SUMMARY OF ARGUMENT 14

ARGUMENT 17

UNDER THE COMMERCE AND DUE PROCESS CLAUSES, NEW JERSEY MAY NOT TAX BENDIX'S INCOME FROM THE SALE OF BENDIX'S MINORITY INVESTMENT IN ASARCO BECAUSE THERE WAS NO "DEFINITE LINK" OR "MINIMUM CONNECTION" BETWEEN BENDIX'S ACTIVITIES IN NEW JERSEY AND BENDIX'S INVESTMENT IN ASARCO 17

A. "The Linchpin of Apportionability in the Field of State Income Taxation Is the Unitary-Business Principle." 17

B. Bendix's Relationship to ASARCO Did Not Provide the "Definite Link" or "Minimum Connection" Between Bendix's Activities in New Jersey and Bendix's Investment in ASARCO That Would Permit New Jersey to Tax Bendix's Income from the Sale of Its Minority Investment in ASARCO 23

C. Bendix's Statements of Corporate Strategy Did Not Forge the "Definite Link" or "Minimum Connection" Between Bendix's Activities in New Jersey and Bendix's Investment in ASARCO That Would Permit New Jersey to Tax Bendix's Income From the Sale of Its Minority Investment in ASARCO 24

1. The New Jersey Opinion Is a Semantic End Run Around This Court's *ASARCO* and *Woolworth* Decisions 25

2. The Relationship Between ASARCO and Woolworth and Their Investments in Their Respective Subsidiaries Was Much Closer Than the Relationship Between Bendix and Its Minority Investment in ASARCO 31

3. The New Jersey Court's Theory That Long-Term Investment Activities "Projec[t] the Existence of a Unitary Business" When They "Have as Their Goal the Growth and Expansion of Existing Corporate Business Activities" Eviscerates the Unitary Business Concept 34

D. This Court's Decision in *Container* Reinforces the Conclusion That There Was No "Definite Link" or "Minimum Connection" Between Bendix's Activities in New Jersey and Bendix's Investment in ASARCO That Would Permit New Jersey to Tax Bendix's Income From Its Investment in ASARCO 36

E. Allowing the New Jersey Opinion to Stand Would Undermine Fundamental Principles of Constitutional Adjudication and Deprive Multistate Corporations of Meaningful Protection From State Taxation of Investment Income 40

CONCLUSION 43

APPENDIX 1a
Comparison of the Facts of This Case with the Facts of *ASARCO* and *Woolworth*

TABLE OF AUTHORITIES

Page(s)

Cases

Adams Express Co. v. Ohio, 165 U.S. 194 (1897) 19

American Home Products Corp. v. Limbach, 49 Ohio St. 3d 158, 551 N.E. 2d 201, *cert. denied*, 111 S.Ct. 673 (1990) 28

ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) ..... *passim*

Bass, Ratcliff & Gretton, Ltd. v.State Tax Comm'n, 266 U.S. 271 (1924) 19

Brunner Enter., Inc. v. Department of Revenue, 452 So. 2d 550 (Fla. 1984) 28

Butler Bros. v McColgan, 315 U.S. 501 (1942) 19

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 18

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) ..... *passim*

Corning Glass Works, Inc. v. Virginia Dep't of Taxation, 241 Va. 353, 402 S.E. 2d 35, *cert. denied*, 112 S.Ct. 277 (1991) 28

Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980) ..... *passim*

F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354 (1982) ..... *passim*

General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965) 19

Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931) 19

Hilton v. South Carolina Pub. Ry. Comm'n, No. 90-848, 60 U.S.L.W. 4056 (Dec. 16, 1991) 41

Hunter v. Bryant, No. 90-1440, 60 U.S.L.W. 3432 (Dec. 16, 1991) 33

James v. International Tel. & Tel. Corp., 654 S.W. 2d 865 (Mo. 1983) 28

Lone Star Steel Co. v. Dolan, 668 P. 2d 916 (Colo. 1983) 28

Miller Bros. v. Maryland, 347 U.S. 340 (1954) 18

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) ..... *passim*

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) 19

NCR Corp. v. Comptroller, 313 Md. 118, 544 A. 2d 764 (1988) 28

Pledger v. Illinois Tool Works, Inc., 306 Ark. 134, 812 S.W. 2d 101, *cert. denied*, 112 S.Ct. 418 (1991) 28

State R.R. Tax Cases, 92 U.S. 575 (1875) 19

Super Valu Stores, Inc. v. Iowa Dep't of Revenue and Finance, No. 320/90-1557 (S. Ct. Iowa Dec. 24, 1991) 28

Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920) 19

Welch v. Texas Dep't of Highways & Pub. Transp., 483 U.S. 468 (1987) 41

Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940) 18

Constitutional Provisions and Statutes

U.S. Const.
art. I, § 8, cl. 3 2
amend. XIV, § 1 2

28 U.S.C.
§ 1257(a) 2

N.J. Stat. Ann.
§ 54:10A-1 10
§ 54:10A-2 11
§ 54:10A-4(k) 11
§ 54:10A-6 11

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-615

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the Supreme Court of New Jersey (Pet. App. A 1a-24a)[1] is reported at 125 N.J. 20, 592 A.2d 536. The opinion of the Superior Court of New Jersey,

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[1] References to the Appendix to the Petition for Certiorari are denominated "Pet. App." followed by a letter assigned to each item and a page reference. References to the Joint Appendix are denominated "J.A." followed by a page reference.

Appellate Division (Pet. App. B 25a-44a), is reported at 237 N.J. Super. 328, 568 A.2d 59. The opinion of the New Jersey Tax Court (Pet. App. C 45a-67a) is reported at 10 N.J. Tax 46.

JURISDICTION

The judgment of the Supreme Court of New Jersey was entered on July 16, 1991. Pet. App. A 24a. The petition for certiorari was filed on October 11, 1991, and was granted on November 27, 1991. The jurisdiction of this Court rests upon 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Constitution, amend. XIV, § 1, provides: "[N]or shall any state deprive any person of life, liberty, or property, without due process of law."

The Commerce Clause of the Constitution, art. I, § 8, cl. 3, provides that the Congress shall have power: "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

Relevant portions of the New Jersey Corporation Business Tax Act, N.J. Stat. Ann. §§ 54:10A-1 *et seq.*, are set forth at Pet. App. D 68a-71a.

STATEMENT

This case concerns the power of a state to tax the capital gain earned by a nondomiciliary corporation from the sale of its minority investment in another corporation with which it had no functional connection and which it

did not control. The precise question here is whether New Jersey may tax a share of the gain that a Michigan-based manufacturing corporation (Bendix) realized from the sale of its 20.6 percent investment in an unrelated metal mining corporation (ASARCO). The facts, which have been stipulated,[2] are not in dispute.

1. Bendix's Business

Petitioner Allied-Signal Inc. is the successor-in-interest to The Bendix Corporation, the original taxpayer in this case. Bendix was a Delaware corporation with its corporate headquarters and commercial domicile in Southfield, Michigan. Stip. ¶¶ 7, 10 (J.A. 154). Formed in 1929 as a manufacturer of aviation and automotive parts, Bendix had evolved by the 1970s into a multinational enterprise with operations in all 50 states. Stip. ¶¶ 7, 11 (J.A. 154–55).

Bendix's business activities were concentrated in four industrial sectors: automotive, aerospace/electronics, industrial/energy, and forest products. Stip. ¶ 11 (J.A. 154–55). All of Bendix's "corporate" (*i.e.*, nonoperating) functions, such as corporate planning, accounting, and management of investments, were based and controlled in Southfield, Michigan. Stip. ¶¶ 7-30 (J.A. 154-61). None of these cor-

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[2] References to the Stipulation of Facts in this case are denominated "Stip." followed by a paragraph reference. The Stipulation of Facts is reproduced at J.A. 152-198. Selected exhibits to the Stipulation of Facts are denominated "Stip. Exh." followed by a letter assigned to each item and a reference to the Joint Appendix.

porate activities was carried on in New Jersey. Stip. ¶¶ 31-38a (J.A. 161-63).

Bendix's activities in New Jersey consisted primarily of the operation of several units in the aerospace/electronics group (flight systems, guidance systems, and test systems) and the operation of one unit in the industrial/energy group (manufacture of electric power generating systems). Stip. ¶¶ 31-34, 36 (J.A. 161-63). Bendix also engaged in a variety of other less significant activities in New Jersey and sold its full range of products to customers in the State. Stip. ¶¶ 35, 37, 38 (J.A 162-63).

2. Bendix's Corporate Strategies and Its History of Selective Acquisitions and Divestitures

As is the practice with many corporations (J.A. 140–41), Bendix's management articulated corporate strategies to guide the operations of its business. Pet. App. A 3a. These strategies changed over the years. Pet. App. A 3a-4a. During the years at issue,[3] one of these strategies was "to diversify the company's holdings and strengthen its operations." Pet. App. A 3a.

"Bendix's strategies to pursue diversification and growth in both domestic and foreign markets" (Pet. App. A 4a) were implemented by a "'careful diversification... into four broad lines of business—automotive, aerospace-electronics, industrial-energy and shelter.'" Pet. App. A 4a (quoting Bendix's 1975 Annual Report, Stip. ¶ 144 (J.A.

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[3] Bendix acquired its ASARCO stock in late 1977 and 1978. It sold the stock in 1981, triggering the gain that is at issue here.

189)).[4] William Agee, who was Chairman and Chief Executive Officer of Bendix from 1977 to 1983, observed in Bendix's 1977 Annual Report that "'we have pursued a deliberate policy of diversification both within and among our lines of business, and geographically as well, in an effort to arrive at a combination of activities that helps insulate the company as a whole from the ups and downs of any one of them.'" Pet. App. A 5a.

One of the ways in which Bendix pursued its corporate strategies of growth and diversification was through "selective" acquisitions and divestitures. Stip. ¶ 128 (J.A. 183). These transactions were designed to foster "corporate expansion in new areas or of existing business activities." Pet. App. 4a. During the late 1960s and 1970s, virtually all of the companies that Bendix acquired were directly related to one of its four core businesses, although Bendix occasionally acquired companies in industries in which it had no prior involvement. Stip. ¶¶ 128-165 (J.A. 183-195).

3. Bendix's Purchase and Sale of Its Minority Interest in ASARCO

a. Bendix's acquisition of a 20.6 percent investment in ASARCO

In 1977, Bendix began to consider the acquisition of an interest in a company in the mining industry. Stip. ¶ 42 (J.A. 165); Stip. Exh. D (J.A. 231-33). In contrast to

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[4] In its annual reports from 1970-81, Bendix referred interchangeably to the "forest products" or "shelter" sectors, which under either name represented building materials, mobile homes, and manufactured homes.

Bendix's historical pattern of acquiring companies that strengthened or complemented its existing lines of business, Bendix's consideration of an investment in a mineral resource company signaled an interest in an industry with which it had no prior connection or experience and which bore no relation to its core businesses. Bendix was nevertheless attracted to the industry because Bendix believed that the industry was undervalued and had potential for significant growth in the 1980s. Stip. ¶ 44 (J.A. 165); Stip. Exh. E. (J.A. 87-118).

In late 1977, Bendix began open market purchases of stock in ASARCO and Kennecott Copper Corporation, two major copper producers. Stip. Exh. F (J.A. 128). By March 1978, Bendix's management had settled on ASARCO as its vehicle for investing in the mining industry. Stip. Exh. E (J.A. 87-118). ASARCO was one of the world's leading producers of nonferrous metals and nonmetallic minerals. It also smelted and refined nonferrous metal ores mined by others. Stip. ¶ 39 (J.A. 163–64).

On April 13, 1978, Bendix's Chairman, William Agee, sought and received approval from the Bendix Board of Directors to purchase up to 21 percent of ASARCO's stock. The decision to limit the investment to approximately 20 percent of ASARCO's stock was based on a desire to avoid investing an undue share of Bendix's assets in a business with which Bendix had no prior experience and to avoid excessive exposure to the cyclicality of ASARCO's earnings. Stip. Exh. F (J.A. 127-128). In this respect, as Agee subsequently testified, the decision to invest in ASARCO was "different" (J.A 28-30), from Bendix's previous decisions to acquire companies, or interests in companies, because "[i]t was a nonoperating situation" (*id.*) and "a situation where it was a passive" investment. (J.A. 54–56).

On April 13, 1978, Bendix and ASARCO entered into a stock purchase agreement under which ASARCO agreed to sell 3,800,000 of ASARCO's shares to Bendix. Stip. ¶ 50 (J.A. 166–67). Bendix in turn agreed that prior to January 1, 1985, it would not acquire more than 21 percent of ASARCO's voting stock and that Bendix would not, either directly or through subsidiaries or affiliates, be a participant in any election contest relating to the election of ASARCO's directors. *Id.* Subsequent to the stock purchase from ASARCO, Bendix made a series of smaller purchases so that, upon completion of all purchases in November 1978 and the retirement by ASARCO of certain outstanding shares, Bendix owned 20.6 percent of ASARCO's stock. Stip. ¶ 51 (J.A. 167).

b. The relationship between Bendix and ASARCO

During the brief period that Bendix held its stock interest in ASARCO (1978-1981), Bendix and ASARCO remained discrete business enterprises with virtually no corporate interaction. Aside from holding the investment itself, Bendix did not engage in any business or activity in New Jersey or elsewhere that involved any business or activity in which ASARCO was engaged. Stip. ¶ 41 (J.A. 164–65). Indeed, the parties have stipulated that "[d]uring the period that Bendix held its investment in Asarco, Bendix and Asarco were unrelated business enterprises each of whose activities had nothing to do with the other." Stip. ¶ 62 (J.A. 169).

The complete absence of any functional relationship between Bendix and ASARCO was reflected in the following stipulated facts:

- There were no common management, officers, or employees of Bendix and ASARCO.

- There was no use by Bendix of ASARCO's corporate plant, offices, or facilities and no use by ASARCO of Bendix's corporate plant, offices, or facilities.

- There was no rent or lease of any property by Bendix from ASARCO and no rent or lease of any property by ASARCO from Bendix.

- Bendix and ASARCO were each responsible for providing their own legal services, contracting services, tax services, finance services and insurance.

- Bendix and ASARCO had separate personnel and hiring policies and separate pension and employee benefit plans.

- Bendix did not lend monies to ASARCO and ASARCO did not lend monies to Bendix.

- There were no joint borrowings by Bendix and ASARCO.

- Bendix did not guaranty any of ASARCO's debt and ASARCO did not guaranty any of Bendix's debt.

- ASARCO had no representatives on Bendix's Board of Directors.

- Bendix did not pledge its ASARCO stock.

- As far as can be determined, there were no sales of product by ASARCO to Bendix or by Bendix to ASARCO. There were certain sales of product in the ordinary course of business by ASARCO subsidiaries to Bendix, but these sales were minute compared to ASARCO'S total sales of $1.7 billion in 1979 and $1.8 billion in 1980. These sales were at arm's length prices and did not come about due to the Bendix investment in ASARCO.

- There were no transfers of employees between Bendix and ASARCO.

Stip. ¶ 62 (J.A. 169-71).

There were in fact only two limited situations in which Bendix and ASARCO had any contact at all. First, in order to account properly for Bendix's investment on the equity method,[5] Bendix would send two or three individuals to ASARCO's New York headquarters each fiscal quarter to gather financial information and would at times receive such information over the telephone or through the mails. Stip. ¶ 56 (J.A. 168). Second, while Bendix held the ASARCO stock, William Agee and Malcolm Baldridge, a Bendix outside director, held seats on ASARCO's 14-member Board of Directors. Consistent with this limited board presence, Bendix did not exert any control over ASARCO. Stip. ¶¶ 53, 54 (J.A. 168).

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[5] Because Bendix owned at least 20 percent of ASARCO's stock, Bendix accounted for this investment for financial reporting purposes under what is known as the "equity method." Under this method, Bendix included in its income its proportionate share of ASARCO's income or loss. Stip. ¶ 55 (J.A. 168).

c. Bendix's sale of its minority interest in ASARCO

In the fall of 1980, less than two years after the acquisition was completed, Bendix decided to sell its ASARCO stock. Stip. ¶ 63 (J.A. 171). Among the reasons for this decision were the appreciation in the stock's price and Bendix's desire to reduce its investment in businesses tied to natural resources. Stip. ¶ 64 (J.A. 171). In October 1980, Bendix and ASARCO entered into an agreement under which ASARCO agreed to purchase all of Bendix's ASARCO shares. Stip. ¶ 66 (J.A. 172). In 1981, Bendix sold its ASARCO shares to ASARCO and realized a capital gain of approximately $211.5 million. Stip. ¶ 67 (J.A. 172).

Bendix used the proceeds from the sale for essentially two purposes: to repurchase shares of outstanding Bendix stock, and to help finance the proposed acquisition of Martin Marietta Corporation. Pet. App. A 9a. Martin Marietta's principal business was in the aerospace industry, where it was a prime contractor producing entire systems, with a strong involvement in missiles. Stip. ¶ 163 (J.A. 194). Bendix, whose aerospace group acted primarily as a subcontractor of component parts for aircraft, believed that the businesses of Bendix and Martin Marietta were complementary. *Id.* Although Bendix was able to purchase 70 percent of the stock of Martin Marietta, Bendix was unable to consummate the takeover of Martin Marietta, and Bendix was thereafter acquired by Allied Corporation. Stip. ¶ 165 (J.A. 194–95).

4. The Tax Assessment

New Jersey imposes its Corporation Business Tax ("CBT"), N.J. Stat. Ann. §§ 54:10A-1 *et seq.*, upon every

corporation for the privilege of exercising its corporate franchise, doing business, employing or owning capital or property, or maintaining an office in the state. *Id.* § 54:10A-2 (Pet. App. D 68a). The CBT is measured by a corporation's "entire net income," which is defined as its federal taxable income with certain adjustments not here at issue. Such income is then apportioned to New Jersey by the familiar three-factor formula of property, payroll, and sales. *Id.* §§ 54:10A-4(k), -6 (Pet. App. D 69a).

On its 1981 CBT return, Bendix excluded from its "entire net income" the gain attributable to the sale of its ASARCO stock. Bendix did so on the ground that New Jersey could not constitutionally include in Bendix's apportionable tax base income from the sale of its investment in a corporation whose business activities had nothing to do with Bendix's business activities in New Jersey.[6] Following an audit, the Director of the Division of Taxation determined that Bendix was not entitled to the full refund claimed on its 1981 return, based in part on his position that Bendix's gain from the sale of its ASARCO stock was taxable by New Jersey.

5. The Proceedings Below

The New Jersey Tax Court and the Appellate Division of the New Jersey Superior Court both cited this Court's decisions in *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) and *F.W. Woolworth Co. v.*

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[6] Bendix also excluded capital gain income from the sale of a subsidiary, United Geophysical Corporation, and interest income that Bendix earned on the proceeds of the ASARCO and United Geophysical sales. Although both of these items were at issue in the courts below, petitioner is not pressing in this Court its claims with respect to these items.

Taxation and Revenue Department, 458 U.S. 354 (1982). Pet. App. C 59a n.3; Pet. App. B 30a, 31a. Indeed, the Appellate Division explicitly recognized that those decisions barred the states from taxing the income earned by a nondomiciliary corporation from its investment in another corporation if the income merely "contributes to or furthers the taxpayer's business." Pet. App. B 31a. Both New Jersey courts nevertheless rejected Bendix's constitutional objections, reasoning that Bendix's activities in managing its investment in ASARCO provided a sufficient link between New Jersey and Bendix's gain to permit New Jersey to tax the gain. The Appellate Division acknowledged, however, that "*Asarco* and *F.W. Woolworth* cast a dark shadow over the Tax Court's decision...." Pet. App. B 32a.

The New Jersey Supreme Court affirmed. Pet. App. A 24a. It recognized that, in order to tax an apportioned share of the income earned by a nondomiciliary corporation conducting a multistate business within the state, the state must have a minimum connection with the activities that generate such income. That minimum connection, the court further recognized, exists when the income in question is derived from a unitary business conducted both within and without the state. "The unitary business principle, characterized as the 'linchpin of apportionability,' provides the foundation to satisfy due process and commerce clause restraints." Pet. App. A 12a (quoting *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980)).

In addressing the question whether Bendix's income from its investment in ASARCO was derived from a unitary business carried on in New Jersey, however, the state court did not focus on the relationship of the underlying activities of the two enterprises, as this Court has in

its unitary business opinions. See *Mobil*; *ASARCO*; *Woolworth*. Indeed, the court took no exception to the parties' stipulation that Bendix and ASARCO "were unrelated business enterprises each of whose activities had nothing to do with the other." Stip. ¶ 62 (J.A. 169).

Rejecting the accepted view that "[t]he tests for determining a unitary business are... controlled... by the relationship between the taxpayer recipient and the affiliate generator of the income that becomes the subject of State tax," the court instead focused on "the intangible nature of corporate operations... to determine the existence of a unitary business." Pet. App. A 18a. The New Jersey court looked to Bendix's broad statements concerning its investment strategies to find that Bendix had an "ingrained policy of acquisitions and divestitures" which "projected the existence of a unitary business." Pet. App. A 21a. The New Jersey court similarly concluded that Bendix "had a business function of corporate acquisitions and divestitures that was an integral operational activity." Pet. App. A 18a-19a.

The New Jersey court was evidently concerned that such investment activity might not establish the requisite link with a unitary business operation of Bendix carried on partly in New Jersey. The court attempted to establish this link by looking beyond the relationship between Bendix's investment activity and Bendix's investment in ASARCO to the use that Bendix made of the proceeds from the sale of its ASARCO stock. The proceeds were used, in part, to acquire stock in Martin Marietta Corporation, and "the purpose of acquiring Martin Marietta was to complement the aerospace-electronics facets of Bendix['s] business, some of which are located in New Jersey." Pet. App. A 20a. According to the New Jersey Supreme Court, this intangible "flow of value" be-

tween the ASARCO investment and Bendix's New Jersey operations helped meet this Court's unitary business standard articulated in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). Pet. App. A 20a-21a.

Finally, the New Jersey Supreme Court found that this Court's decisions in *ASARCO* and *Woolworth* were distinguishable because, in the *ASARCO* case, ASARCO's stock investments were "'not integral to nor a necessary part of [ASARCO's] business operation'" (Pet. App. A 21a), and because ASARCO did not use "'its stock as security for borrowing of working capital [to] acquire stock or securities in other companies.'" *Id.* The New Jersey Supreme Court also commented that "neither *ASARCO* nor *F.W. Woolworth* involved the purchase of 4,000,000 shares of outstanding corporate stock to enhance the stockholder value of the corporation." Pet. App. A 21a.

SUMMARY OF ARGUMENT

A. Under the Commerce and Due Process Clauses, a state does not have the power to tax a person, property or transaction unless there is a definite link or minimum connection between the state and the person, property or transaction. In the context of state corporate income tax apportionment, this nexus requirement is reflected in the unitary business principle. When a multistate enterprise conducts a unitary business within and without a state, the state has the requisite nexus to both the in-state and out-of-state activities of the business to include all of the income generated by these activities in the taxpayer's apportionable tax base. When a nondomiciliary taxpayer's activities carried on within the state are not unitary with activities carried on outside the state, however, the state may not include the income from

those out-of-state activities in the taxpayer's apportionable tax base.

In a series of decisions in the early 1980s,[7] this Court defined a unitary business as one characterized by functional integration, centralization of management, and economies of scale. Applying this standard to cases involving the power of a state to tax income earned by nondomiciliary corporations from their investments in other corporations, this Court held that the apportionability of the income depended on whether it was earned in the course of activities related in some concrete way to the taxpayer's business activity in the taxing state.

B. The relationship between Bendix and ASARCO did not provide the constitutionally required nexus to justify New Jersey's inclusion in Bendix's apportionable tax base of Bendix's income from its investment in ASARCO. The undisputed facts show that Bendix and ASARCO were not engaged in a unitary business. Hence the "linchpin of apportionability" (*Mobil*, 445 U.S. at 439) was absent.

C. The court below reasoned that Bendix's investment in ASARCO was part of Bendix's unitary business because (i) Bendix had a long-term corporate strategy of acquisitions and divestitures to expand and diversify its business and (ii) Bendix's purchase and sale of ASARCO fell within this "operational" strategy. In *ASARCO* and *Woolworth*, however, this Court considered and rejected a unitary business theory identical in all

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[7] *Mobil*; *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980); *ASARCO*; *Woolworth*; *Container*.

essential respects to the theory advanced by the court below. This Court unequivocally repudiated such a definition of a unitary business based on "corporate *purpose*," *ASARCO*, 458 U.S. at 326 (emphasis in original), observing that it would "destroy the concept," *id.*, and "trivialize this due process limitation." *Woolworth*, 458 U.S. at 363.

While the analysis by the court below was couched in terms of Bendix's "ingrained acquisition-divestiture policy," which that court characterized as amounting to "integral operational activity" (Pet. App. A 18a-19a), this is simply another way of describing Bendix's business purpose for making an investment. Attaching the label "integral operational" to capital investment activities does not change their essential character. Whatever "policy" may have driven Bendix's investment in ASARCO, it was a passive investment: Bendix did not control and was not functionally integrated with ASARCO. In this respect, a comparison of the actual relationship between Bendix, ASARCO, and Woolworth and their respective investments reveals that Bendix's investment in ASARCO was even less eligible to be classified as unitary than the investments the Court found non-unitary in *ASARCO* and *Woolworth*.

Furthermore, the decision below makes the apportionability of investment income turn upon the vagaries of the investment's relationship to the corporation's strategy rather than upon the investment's relationship in some concrete way to the taxpayer's in-state activities. It thereby erases the sharp line that this Court has drawn between investments that have a definite link or connection to the taxpayer's business activities in the taxing state and those that merely serve the function of diversifying the corporate portfolio.

D. This Court's decision in *Container*, which expressly reaffirmed *ASARCO* and *Woolworth*, reinforces the conclusion that New Jersey lacks the requisite nexus with Bendix's investment in ASARCO to permit New Jersey to tax Bendix's gain from the sale of its ASARCO stock.

E. Allowing the decision below to stand would undermine the doctrine of *stare decisis*. It would also remove meaningful limitations on the states' power to tax the investment income of multistate corporations, exposing such income to taxation by any state in which the corporation did business, regardless of the connection between the taxpayer's investment and its activities in the taxing state. And it would erode the principles of fairness and constitutional restraint on which this Court's unitary business principles are so soundly based.

ARGUMENT

UNDER THE COMMERCE AND DUE PROCESS CLAUSES, NEW JERSEY MAY NOT TAX BENDIX'S INCOME FROM THE SALE OF BENDIX'S MINORITY INVESTMENT IN ASARCO BECAUSE THERE WAS NO "DEFINITE LINK" OR "MINIMUM CONNECTION" BETWEEN BENDIX'S ACTIVITIES IN NEW JERSEY AND BENDIX'S INVESTMENT IN ASARCO

A. "The Linchpin of Apportionability in the Field of State Income Taxation Is the Unitary-Business Principle."

A fundamental limitation on the states' power to

tax—a limitation arising out of both the Due Process and Commerce Clauses—is that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954). When such a "substantial nexus" (*Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)) exists, a state may properly demand a return for the "protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). When no substantial nexus exists, however, the state has not "given anything for which it can ask return." *Id.*

In the context of state corporate income taxation, the nexus requirement is reflected in the unitary business principle, which confines the states' power to include income from out-of-state activities in the taxpayer's apportionable tax base. If a taxpayer is carrying on a single "unitary" business within and without the state, the state has the requisite nexus to both the in-state and out-of-state activities of the business to justify the state's inclusion of all of the income generated by these activities in the taxpayer's apportionable tax base. By the same token, however, when the activities carried on within the state are not unitary with the activities carried on elsewhere, the state is constitutionally constrained from including the income arising from those out-of-state activities in the taxpayer's apportionable tax base, at least when the taxpayer is not domiciled in the taxing state.

In a series of decisions handed down during the early 1980s,[8] this Court delineated the contours of the unitary business principle as applied to state corporate income taxes imposed upon nondomiciliary taxpayers.[9] In *Mobil*, Vermont sought to include in Mobil's appor-

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[8] *Mobil; Exxon; ASARCO; Woolworth; Container.*

[9] The unitary business principle itself is a venerable one. It derives from the "unit rule" developed in the late nineteenth century for apportioning property values of interstate railroad, telegraph, and express companies to state and local taxing jurisdictions. See, *e.g., State R.R. Tax Cases*, 92 U.S. 575, 608 (1875) ("It may well be doubted whether any better mode of determining the value of that portion of the track within any one county has been devised than to ascertain the value of the whole road, and apportion the value within the county by its relative length to the whole"); *Adams Express Co. v. Ohio*, 165 U.S. 194, 222 (1897) ("[W]hile the unity which exists may not be a physical unity, it is something more than a mere unity of ownership. It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business").

None of the state corporate income tax cases reaching the Court prior to 1980 undertook a detailed exploration into the scope of the unitary business doctrine. This was very likely attributable to the fact that the taxpayers in those cases, who were typically engaged in manufacturing and mercantile activity, were indisputably carrying on a unitary business within and without the taxing state. See *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924) ("the Company carried on the unitary business of manufacturing and selling ale"); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 133 (1931) ("the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business"); *Butler Bros. v McColgan*, 315 U.S. 501, 508 (1942) (taxpayer's business is "unitary... [t]here is unity of ownership and management. And the operation of the central buying division alone demonstrates that functionally the various branches are closely integrated") (citation omitted); *General Motors Corp. v. District of Columbia*, 380 U.S. 553 (1965); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

tionable tax base dividends that Mobil received from its foreign subsidiaries engaged in the oil and gas business. Articulating the controlling doctrine, this Court declared that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle." 445 U.S. at 439. The Court described a unitary business as one characterized by "functional integration, centralization of management, and economies of scale." *Id.* at 438. Since Mobil was engaged in a functionally integrated, centrally managed business extending from oil wells in foreign countries to gas pumps in Vermont, it followed that Vermont had the requisite nexus with Mobil's out-of-state activities to include income from such activities in Mobil's apportionable tax base. The fact that the income was received in the form of dividends, reflecting profits from such activities, rather than direct operating income, was of no constitutional significance. *Id.* at 440-41. Mobil had failed to prove that its dividend income was "earned in the course of activities unrelated to" its business activity in the taxing state. *Id.* at 439. *Exxon*, which followed on *Mobil*'s heels, was to the same effect.[10]

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[10] *Exxon* reiterated that "[t]he 'linchpin of apportionability' for state income taxation of an interstate enterprise is the 'unitary-business principle.'" 447 U.S. at 223 (quoting *Mobil*, 445 U.S. at 439). It focused on the question whether Exxon's petroleum marketing activities carried on in Wisconsin were related to its refining and production activities carried on elsewhere to justify including the income from all such activities in Exxon's apportionable tax base. Determining that the case "involves a highly integrated business" (*id.* at 224) characterized by internal transfers of raw materials (*id.* at 226), centralized purchasing (*id.* at 224), and interdepartmental coordination (*id.*), the Court concluded that Exxon's production, refining, and marketing operations constituted a unitary business. Consequently, Wisconsin had the requisite nexus with the rest of Exxon's activities to include income from such activities in Exxon's apportionable tax base.

ASARCO involved the question whether Idaho could include within a nondomiciliary corporation's apportionable tax base intangible income (dividends, interest, and capital gains) that the corporation had derived from its investment in subsidiaries. As in *Mobil* and *Exxon*, the answer to that question depended on whether the income derived from the taxpayer's unitary business being carried on within and without the taxing state. ASARCO's relationship to its subsidiaries did not reveal the functional integration, centralization of management, or economies of scale that are essential to the existence of a unitary business. *ASARCO*, 458 U.S. at 320-24. Because the subsidiaries were "discrete business enterprises" (*ASARCO*, 458 U.S. at 320, quoting *Exxon*, 447 U.S at 224), this Court was satisfied that there was no "minimum connection" between ASARCO's business activities in Idaho and the activities of ASARCO's subsidiaries. Consequently, this Court held there was no constitutional predicate for sweeping income from ASARCO's investments in its subsidiaries into its Idaho apportionable tax base.

Woolworth, a companion case to *ASARCO*, reiterated and reinforced *ASARCO*'s teachings. This Court held that New Mexico could not include in a New York-based retailer's apportionable tax base intangible income that the retailer derived from its subsidiaries, because the subsidiaries operated "discrete business enterprise[s]" (*Woolworth*, 458 U.S. at 372) and "a 'showing has been made that income unconnected with the unitary business has been used in the' levy of the New Mexico tax." *Id.* (quoting *Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942)).

In *Container*, this Court revisited the unitary business question in the context of a worldwide paperboard

manufacturing business operated by the taxpayer and its foreign subsidiaries. Noting that the unitary business principle was now "well-established," 463 U.S. at 176, the Court emphasized the requirement that the apportionability of income derived from "the out-of-state activities of the purported 'unitary business' be related in some concrete way to the instate activities." *Id.* at 166. The Court continued:

> The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation.

Id. Under these standards, the Court found that the taxpayer and its subsidiaries were engaged in a unitary business in light of the taxpayer's assistance to its subsidiaries in obtaining equipment, filling personnel needs, making and guaranteeing loans, and providing technical aid. *Id.* at 179-80. The Court easily distinguished *ASARCO* and *Woolworth* as cases not involving "a 'functionally integrated enterprise'... which the State is entitled to tax as a single entity." *Id.* at 179 (citation omitted).

Mobil, Exxon, ASARCO, Woolworth, and *Container* thus establish the broad principles for determining whether a unitary link exists between a nondomiciliary taxpayer's business activities within the state and its investment in another corporation. Such a link must be found before a state may constitutionally include income from such investment in the taxpayer's apportionable tax base. But as we demonstrate in the succeeding sections of

this brief, no such unitary link existed between Bendix's activities in New Jersey and its investment in ASARCO.

B. Bendix's Relationship to ASARCO Did Not Provide the "Definite Link" or "Minimum Connection" Between Bendix's Activities in New Jersey and Bendix's Investment in ASARCO That Would Permit New Jersey to Tax Bendix's Income from the Sale of Its Minority Investment in ASARCO

There can be no serious claim in this case that the business relationship between Bendix and ASARCO provided a constitutionally sufficient predicate for inclusion in Bendix's apportionable tax base of its income from its investment in ASARCO.[11] The undisputed facts show that "[d]uring the period that Bendix held its investment in Asarco, Bendix and Asarco were unrelated enterprises each of whose activities had nothing to do with the other." Stip. ¶ 62 (J.A. 169); see pp. 7-9, *supra*. Moreover, the record does not contain anything that could remotely be read to suggest that the relationship between Bendix and ASARCO was characterized by the unitary attributes of functional integration, centralized management, or economies of scale. The conclusion is inescapable that Bendix and ASARCO remained "discrete business enterprise[s]" (*Exxon*, 447 U.S. at 224) and did not conduct a unitary business. Their relationship therefore fails to provide the "minimum connection" between Bendix's New Jersey business activities and its

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[11] Implicitly recognizing this point, the New Jersey Supreme Court did not rest its decision on this ground. Pet. App. A 18a-22a. See Subsection C, *infra*.

minority investment in ASARCO that would justify the inclusion in Bendix's apportionable tax base of its income from its investment in ASARCO. See *Mobil; Exxon; ASARCO; Woolworth; Container.*

C. Bendix's Statements of Corporate Strategy Did Not Forge the "Definite Link" or "Minimum Connection" Between Bendix's Activities in New Jersey and Bendix's Investment in ASARCO That Would Permit New Jersey to Tax Bendix's Income From the Sale of Its Minority Investment in ASARCO

Because the functional relationship between Bendix and ASARCO wholly failed to provide a unitary link between Bendix's activities in New Jersey and its investment in ASARCO, the court below was compelled to look elsewhere in its effort to fashion such a link. In so doing, the court looked to the investment relationship between Bendix and its ASARCO stock. According to the New Jersey Supreme Court, "[w]hen capital investment activities are long-term integral operational corporate functions rather than passive investment functions, they can serve as the basis for concluding a unitary business exists." Pet. App. A 19a. Because Bendix, in the court's view, "essentially had a business function of corporate acquisitions and divestitures that was an integral operational activity" *id.* at 18a-19a, and because Bendix's investment in ASARCO, according to the court, was a part of this activity, the court claimed that it followed that Bendix's investment in ASARCO was part of Bendix's unitary "integral operational" capital investment business. Under this theory, New Jersey enjoyed the requisite unitary link with Bendix's investment in ASARCO because there was a "flow of value" generated in part by

subsequent use of proceeds of the sale of the ASARCO stock to help finance Bendix's unsuccessful takeover attempt of Martin Marietta, whose operations would have complemented Bendix's New Jersey aerospace business. Pet. App. A 20a-21a. Upon examination, however, the New Jersey Supreme Court's theory collapses.

1. The New Jersey Opinion Is a Semantic End Run Around This Court's *ASARCO* and *Woolworth* Decisions

In *ASARCO* and *Woolworth*, this Court considered and rejected a unitary business theory identical in all essential respects to the theory advanced by the New Jersey court. Despite the absence of a unitary link between the underlying activities of ASARCO and Woolworth and their respective subsidiaries (see p. 21, *supra*), Idaho and New Mexico contended in *ASARCO* and *Woolworth* that a unitary link nevertheless existed.

Idaho argued that "intangible income should be considered a part of a unitary business if the intangible property (the shares of stock) is 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.'" *ASARCO*, 458 U.S. at 326 (quoting Brief for Appellee 4). Idaho likewise urged "that income from intangible property be considered part of a unitary business when the intangibles 'contribute to or relate to or are [in] some way in furtherance of the taxpayer's own trade or business.'" *Id.* (quoting Tr. of Oral Arg. 25). Idaho further asserted that "[i]t is this integration—*i.e.*, between the business use of the intangible asset (the shares of stock) and ASARCO's mining, smelting, and refining business—which makes the income part of the unitary business." *Id.* (quoting Brief for Appellee 4).

This Court unequivocally repudiated this concept of a unitary business based on the purported unitary links between a corporation's investment objectives and its operations:

> This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary.

ASARCO, 458 U.S. at 326 (footnote omitted).

New Mexico, like Idaho, argued that the taxpayer's income from its investments in its subsidiaries was taxable because the investments were "motivated by business considerations" (Brief for Appellee at 16, *Woolworth*) and were an "integral part" of the taxpayer's business. *Id.* at 18. New Mexico also contended that the investments could be considered part of the taxpayer's unitary business because, as the state court had reasoned:

> "The possession of large assets by subsidiaries is a business advantage of great value to the parent; 'it may give credit which will result in more economical business methods; it may give a standing which shall facilitate purchases; it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and pres-

> tige.' *Flint v. Stone Tracy Co.*, 220 U.S. 107, 166 ... (1911)." 95 N.M., at 529, 624 P.2d, at 38.

Woolworth, 458 U.S. at 363 (quoting the New Mexico court).

As it had done in *ASARCO*, this Court again squarely rejected the notion that income from a nondomiciliary taxpayer's investments was part of a taxpayer's unitary business merely because the investment advanced the taxpayer's business purposes:

> The state court's reasoning would trivialize this due process limitation by holding it satisfied if the income in question 'adds to the riches of the corporation....' Income, from whatever source, always is a 'business advantage' to a corporation. Our cases demand more. In particular, they specify that the proper inquiry looks to 'the underlying unity or diversity of business enterprise,' not to whether the nondomiciliary parent derives some economic benefit—as it virtually always will—from its ownership of stock in another corporation.

Woolworth, 458 U.S. at 363-64 (citations and footnote omitted).[12]

The New Jersey Supreme Court's unitary analysis may differ somewhat in form, but it does not differ in substance, from the discredited unitary theories advanced by the states in *ASARCO* and *Woolworth*. In each case, the state took the position that a nondomiciliary corporate taxpayer's income from an investment in another corporation should be includible in the taxpayer's apportionable tax base even if the underlying activities of the two corporations are not unitary. In each case, the grounds claimed for including such income in the tax-

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[12] Most state courts have faithfully adhered to the teachings of *ASARCO* and *Woolworth* and have recognized that they preclude apportionment of capital gain from the sale of non-unitary subsidiaries. *Super Valu Stores, Inc. v. Iowa Dep't of Revenue and Finance*, No. 320/90-1557 (S. Ct. Iowa Dec. 24, 1991); *Pledger v. Illinois Tool Works, Inc.*, 306 Ark. 134, 812 S.W.2d 101, *cert. denied*, 112 S. Ct. 418 (1991); *Corning Glass Works, Inc. v. Virginia Dep't of Taxation*, 241 Va. 353, 402 S.E.2d 35, *cert. denied*, 112 S. Ct. 277 (1991); *James v. International Tel. & Tel. Corp.*, 654 S.W.2d 865 (Mo. 1983) (*en banc*); cf. *Brunner Enter., Inc. v. Department of Revenue*, 452 So. 2d 550 (Fla. 1984). Indeed, even where state courts have held that, in some circumstances, a taxpayer's income is apportionable when derived from an investment where the payor is not unitary with the payee, virtually all of them have done so on the ground that the income from the investments was essential to the operation of the taxpayer's own unitary business. *American Home Products Corp. v. Limbach*, 49 Ohio St. 3d 158, 160-162, 551 N.E.2d 201, 204-205, *cert. denied*, 111 S. Ct. 63 (1990); *NCR Corp. v. Comptroller*, 313 Md. 118, 133-41, 544 A.2d 764, 771-75 (1988); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916, 924-25 (Colo. 1983). No such claim could be made in this case. Stip. ¶ 62 (J.A. 169-171); see pp. 38-40, *infra*. Nevertheless, the amicus brief filed on behalf of 20 states in support of Virginia's unsuccessful petition for certiorari in the *Corning Glass Works* case, *supra*, makes a solid showing of the contemporary overzealousness with which the taxing authorities in some states are seeking substantial new sources of revenue without regard to the constitutional limitations applicable here.

payer's apportionable tax base were that the investment *qua* investment was related to the taxpayer's activities in the taxing state. And in each case, the alleged "unitary" link between the investment and the taxpayer's activities in the taxing state was the taxpayer's business purpose.

To be sure, the phrasing of the New Jersey court's analysis was more embellished than the analysis proffered by the states in the *ASARCO* and *Woolworth* cases. Rather than relying on the naked "business purpose" of the investment as creating a unitary link between the taxpayers' business activities in the state and their investment, the New Jersey court found such a link in Bendix's "ingrained acquisition-divestiture policy designed to expand and enhance its existing operations as well as to move it into other fields of business." Pet. App. A 18a. According to the New Jersey court, capital investment activities can serve as the basis for concluding a unitary business exists, when they are "long-term integral operational corporate functions" (Pet. App. A 19a), or constitute "integral operational activity." *Id.*

But attaching the label "integral operational" to capital investment activities does not change their character. There is no blinking the fact that, whatever the "purpose" or "policy" underlying Bendix's investment in ASARCO, it was a passive investment; Bendix did not control and was not functionally integrated with ASARCO. Stip. ¶¶ 41, 54 (J.A. 164-65, 168). In these respects, Bendix's investment in ASARCO was indistinguishable from the investments the Court found non-unitary in *ASARCO* and *Woolworth*. The assumption that Bendix's investment in ASARCO might have been motivated by Bendix's strategy of growth and diversification (see pp. 4-5, *supra*), or indeed, by an "ingrained policy of acquisitions and divestitures" (Pet. App. A 21a) does not

make the investment unitary any more than ASARCO's and Woolworth's corporate purposes for acquiring their investments made their respective investments unitary.

This is not to suggest that many, if not most, of Bendix's investments in corporations and other assets were not in fact part of its unitary business. These were acquisitions of operating companies and the assets of companies that fell squarely within Bendix's four core business groups and which enhanced Bendix's existing product areas.[13] See pp. 3-5, *supra*; Stip. ¶¶ 128-165 (J.A. 183-95). The reason that these investments were part of Bendix's unitary business, however, was not because they were made pursuant to some "long-term planning strategy" or an "ingrained acquisition-divestiture policy." Pet. App. A 18a. It was because they were related to

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[13] For example, during the late 1960s and 1970s, Bendix acquired P & D Manufacturing Company, a manufacturer of automotive ignition parts, Stip. ¶ 132 (J.A. 185), Fram Corporation, a manufacturer of automotive oil and air filters, Stip. ¶ 133 (J.A. 185), and the Autolite spark plug manufacturing facility and the Autolite trademark. Stip. ¶ 142 (J.A. 188). These acquisitions extended Bendix's reach into the automotive industry, particularly in the automobile "after market." Stip. ¶ 128 (J.A. 183). During the late 1960s, Bendix acquired Besly-Welles, a manufacturer of grinding machines and metal cutting tools, Stip. ¶ 132 (J.A. 185), Titan Abrasives Company, a manufacturer of abrasive grinding disks for the cutting tool industry, Stip. ¶ 133 (J.A. 185), and American Abrasive Company, a manufacturer of abrasive grains, powders, and wheels. Stip. ¶ 137 (J.A. 187). These acquisitions furthered Bendix's involvement in the industrial/energy sector. During the 1970s, Bendix acquired Bass & Co., a retailer of specialty building materials, Caradco, a manufacturer of wood windows and doors, Modern Materials, a producer of aluminum building products, and Coin Millwork, a maker of moldings. Stip. ¶ 129 (J.A. 184). All of these companies used forest products as raw materials, and their acquisition was a natural extension of Bendix's forest products business. *Id.*

Bendix's business through centralization of management, functional integration, and economies of scale. Indeed, these investments would have been part of Bendix's unitary business even if there had been no strategy behind their acquisition. It is not the purpose or strategy behind a corporate investment that makes it unitary; it is the functional relationship of the corporation to the investment that is critical.

2. The Relationship Between ASARCO and Woolworth and Their Investments in Their Respective Subsidiaries Was Much Closer Than the Relationship Between Bendix and Its Minority Investment in ASARCO

A comparison of the relationship between Bendix, ASARCO, and Woolworth and their respective investment demonstrates that Bendix had a more attenuated relationship to its investment in ASARCO than either ASARCO or Woolworth had to their investments in their respective subsidiaries. Since this Court has held that the relationship of ASARCO and Woolworth to their subsidiaries is non-unitary from both a functional and an investment perspective, Bendix's investment in ASARCO cannot be characterized as unitary unless the holdings of *ASARCO* and *Woolworth* are to be abandoned.

As the facts summarized in the Appendix to this brief confirm, the conclusion is inescapable that *ASARCO* and *Woolworth* presented considerably stronger cases for arguing that the taxpayer's investments were part of the taxpayer's unitary business than does the instant controversy. ASARCO's investments were in companies in ASARCO's own line of business, that dealt with ASARCO as a customer and a significant supplier of raw

materials to ASARCO's business, and that, in some cases, were majority-owned by ASARCO. Woolworth's investments were in companies that were in Woolworth's own line of business, that were wholly-owned or majority-owned by Woolworth, and that Woolworth had the potential to control and did control with respect to major financial decisions. By way of contrast, Bendix's investment was in a company in a completely unrelated line of business, that had no operational dealings with Bendix, that was only 20.6 percent owned by Bendix, and that Bendix had no potential to control. However one views the strength of the states' unitary arguments in *ASARCO* and *Woolworth*—and this Court was satisfied that the arguments were insufficient—it is simply not possible to conclude on the basis of these facts that Bendix's investment in ASARCO was more "unitary" with its business than were ASARCO's and Woolworth's investments with their businesses.

Indeed, the strained attempt of the court below to paint *ASARCO* and *Woolworth* as "factually distinguishable," Pet. App. A 21a, serves only to reinforce the conclusion that the instant case has a much weaker basis for a unitary determination than did *ASARCO* and *Woolworth*. The court declares that "ASARCO's stock investments were 'not integral to nor a necessary part of [ASARCO's] business operation.'" Pet. App. A 21a (quoting *ASARCO*, 458 U.S. at 324-25 n.21, quoting the Idaho trial court). But the court utterly fails to explain how Bendix's investment in ASARCO was more "integral" to Bendix's business operations than ASARCO's investments in *ASARCO* were integral to ASARCO's business operations. In light of the facts of both cases (see Appendix, *infra*), the court's inability to come up with such an explanation is understandable. Moreover, the New Jersey court's observation that, in

ASARCO, ASARCO did not use "its stock as security for borrowing of working capital [to] acquir[e] stock or securities in other companies," *id.*, hardly distinguishes *ASARCO* from the present case; Bendix did not pledge its ASARCO stock, there were no intercompany loans, no joint borrowings, and no intercompany guarantees. Stip. ¶ 62 (J.A. 170).

Finally, the court's comment that "neither *ASARCO* nor *F.W. Woolworth* involved the purchase of 4,000,000 shares of outstanding corporate stock to enhance the stockholder value in the corporation" (Pet. App. A 21a) provides the most telling sign that the court has ignored the teachings of *ASARCO* and *Woolworth* by embracing the rejected view that "corporate *purpose* should define unitary business." *ASARCO*, 458 U.S. at 326 (emphasis in original). If the use of the proceeds from the sale of an investment "to enhance the stockholder value in the corporation" (Pet. App. A 21a) makes the investment "unitary," then the point would truly be reached at which "the 'unitary business' limitation becomes no limitation at all." *ASARCO*, 458 U.S. at 326. In sum, the court below has put forth a ruling which—as this Court recently said in another context, *Hunter v. Bryant*, No. 90-1440, decided December 16, 1991, 60

U.S.L.W. 3432—"ignores the import of these decisions."[14]

3. The New Jersey Court's Theory That Long-Term Investment Activities "Projec[t] the Existence of a Unitary Business" When They "Have as Their Goal the Growth and Expansion of Existing Corporate Business Activities" Eviscerates the Unitary Business Concept

When this Court rejected the notion that the corporate purpose for which an investment is held can provide the "linchpin of apportionability" (*Mobil*, 445 U.S. at 439), it sought to inter the genre of unitary analysis that the New Jersey Supreme Court is seeking to resurrect. This Court has recognized that, before a state may tax a nondomiciliary taxpayer's income from its investments, the Due Process and Commerce Clauses demand a more concrete connection between a taxpayer's in-state activities and the investments than the fact that the investments "contribute to or relate to or are in some way in furtherance of the taxpayer's own unitary business." *ASARCO*, 458 U.S. at 326 (quoting Tr. of Oral Arg. 25).

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[14] In addition to its unequivocal rejection of the New Jersey court's theory in *ASARCO*, this Court in *Woolworth* made a similar point in dismissing the significance that the New Mexico tribunals had attached to the fact that Woolworth had commingled its dividends with its general funds and used them "for general corporate operating purposes." *Woolworth*, 458 U.S. at 364 n.11. "This analysis likewise subverts the unitary-business limitation. *All* dividend income—irrespective of whether it is generated by a 'discrete business enterprise,' *Mobil*, 445 U.S. at 439—would become part of a unitary business if the test were whether the corporation commingled dividends from other corporations, whether subsidiaries or not." *Id.* (emphasis in original).

The Court thus repudiated a unitary business doctrine constructed on the broad statements of corporate strategy that emanate on a regular basis from corporate board rooms across the country and that fill the pages of annual corporate reports.

If the New Jersey Supreme Court's decision were allowed to stand, however, it would establish a unitary business doctrine largely defined by corporate rhetoric rather than by operational functions. The court's opinion purports to identify a discrete "business function" (Pet. App. A 18a) of "capital investment activities" (Pet. App. A 19a) that "become an integral part of a corporation's business." *Id.* But what distinguishes capital investment activities that are "long-term integral operational corporate functions" (Pet. App. A 19a), from those that are merely "passive investment functions" (*id.*)? The answer, according to the New Jersey court's analysis, is to be found in corporate strategy, as articulated in annual reports, memoranda, and other indicia of corporate policy. Pet. App. A 3a-6a. But from the standpoint of the fundamental question whether there is a "definite link" or "minimum connection" between Bendix's unitary business activities conducted in part in New Jersey and its investment in ASARCO, it makes no difference whether Bendix's investment in ASARCO was pursuant to an "ingrained acquisition-divestiture" strategy, Pet. App. A 18a, a strategy of "growth and diversification for the 80's," Stip. Exh. E (J.A. 87), or no strategy at all. Unless Bendix's investment in ASARCO relates "in some concrete way to the in-state activities... beyond the mere flow of funds arising out of a passive investment or a distinct business operation," *Container*, 463 U.S. at 166, the essential unitary link has not been forged. Corporate rhetoric alone cannot provide the requisite nexus.

The New Jersey court recognized this problem. Pet. App. A 20a-21a. It attempted to buttress its conclusion by looking beyond the relationship of Bendix's investment in ASARCO itself to the use that Bendix made of the proceeds from the sale of its ASARCO stock, when Bendix no longer had any connection whatsoever with ASARCO. The court noted that the proceeds were used to acquire Martin Marietta stock, and "the purpose of acquiring Martin Marietta was to complement the aerospace-electronics facets of Bendix['s] business, some of which are located in New Jersey." Pet. App. A 20a. But if the use of proceeds from an investment, *after the taxpayer has disposed of all of its interest in the investment*, can establish a due process link between the investment and the state in which the proceeds are subsequently invested, the due process limitations on state taxation have not merely been "trivialize[d]," *Woolworth*, 458 U.S. at 363, they have been obliterated.[15]

D. This Court's Decision in *Container* Reinforces the Conclusion That There Was No "Definite Link" or "Minimum Connection" Between Bendix's Activities in New Jersey and Bendix's Investment in ASARCO That Would Permit New Jersey to Tax Bendix's Income From Its Investment in ASARCO

Just one year after the Court handed down its 1982

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[15] This Court has discredited the theory underlying the New Jersey court's analysis—that the subsequent use of proceeds for business purposes can provide the answer to the unitary business inquiry. The Court declared that such an approach "subverts the unitary-business limitation." *Woolworth*, 458 U.S. at 364 n.11. See note 14, *supra*.

decisions in *ASARCO* and *Woolworth*, it decided *Container*. *Container* raised the question whether a domestic paperboard manufacturer was carrying on a unitary business with its foreign subsidiaries, which were engaged in the same line of business as their parent. The relationship between the taxpayer and its subsidiaries in certain respects "was decidedly close." *Container*, 463 U.S. at 173. The taxpayer played a substantial role in lending funds to the subsidiaries and in guaranteeing loans provided by others; it provided advice and consultation regarding manufacturing techniques, engineering, design, architecture, insurance, and cost accounting; it assisted its subsidiaries in their procurement of equipment and in filling personnel needs; it played a supervisory role in providing general assistance to the subsidiaries; and there was a spillover of good will between the taxpayer and its subsidiaries and considerable interplay in the area of corporate expansion. *Id.* at 173, 179. Without determining whether any one of these factors would suffice by itself to prove the existence of a unitary business, the Court held that in combination they clearly demonstrated the reasonableness of the state court's conclusion that a unitary business existed. *Id.* at 179-80.

After adverting to the factors that made *Container* and its subsidiaries unitary, the Court was careful to note that "[i]n each of these respects, this case differs from *ASARCO* and *F.W. Woolworth*, and clearly comes closer than those cases did to presenting a 'functionally integrated enterprise,' *Mobil*, [445 U.S.] at 440, which the State is entitled to tax as a single entity." 463 U.S. at 179 (footnote omitted). The Court went on to point out that in *Woolworth* no phase of any subsidiary's business was integrated with the parent's, each subsidiary made business decisions independently of the parent, each subsidiary was responsible for obtaining financing from

sources other than the parent, and there were virtually no exchanges of employees between the subsidiaries and the parent. *Id.* at n.18. In light of the fact that Bendix's relationship to ASARCO was even more attenuated than ASARCO's and Woolworth's relationships to their subsidiaries, see Appendix, *infra*, it is plain that *Container*, by reaffirming the line between cases like *ASARCO* and *Woolworth*, on the one hand, and *Mobil* and *Exxon*, on the other, has likewise reinforced the conclusion that Bendix's minority investment in ASARCO cannot be characterized as part of Bendix's unitary business.

Furthermore, this Court in *Container* affirmed its repudiation of the unitary theory advanced by the states in *ASARCO* and *Woolworth* and adopted here by the New Jersey Supreme Court. In *Container*, this Court stated that in *ASARCO*: "We held specifically that to accept the State's theory of the case would not only constitute a misapplication of the unitary business concept, but would 'destroy' the concept entirely." *Container* at 177 n.15 (citation omitted).

The court below nevertheless seizes on a footnote in *Container* in an effort to shore up its theory that Bendix's investment in ASARCO was part of Bendix's unitary business because, in the court's eyes, it was part of a "long-term integral operational corporate functio[n]" rather than a "passive investment functio[n]." Pet. App. A 19a. However, the footnote (463 U.S. at 180 n.19) does not support the theory, at least insofar as that theory is relevant to this case.

In the footnote, the Court in *Container* elaborated upon the state court's reliance on the flow of capital resources from Container to its subsidiaries through loans and loan guarantees to support its conclusion that

Container and its subsidiaries were unitary. The footnote states:

> There is no indication that any of these capital transactions were conducted at arm's length, and the resulting flow of value is obvious. As we made clear in another context in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 50-53 (1955), capital transactions can serve either an investment function or an operational function. In this case, appellant's loan and loan guarantees were clearly part of an effort to ensure that "[t]he overseas operations of [appellant] continue to grow and to become a more substantial part of the company's strength and profitability."

Container, 463 U.S. at 180 n.19 (quoting Container Corporation's 1964 Annual Report 6).

From this the court below reasoned that "[w]hen the investments in affiliates that generate capital gains become an integral part of a corporation's business... a basis is established for making the income from those capital gains subject to a State's apportionable tax formula." Pet. App. A 19a-20a. Assuming *arguendo* the court is correct in its observation that income from investments which are "an integral part of a corporation's business" is apportionable, this does nothing to advance the argument that Bendix's gain from its investment in ASARCO was apportionable. This is because Bendix's investment in ASARCO cannot by any stretch of the imagination be characterized as an "integral part" of Bendix's business. The facts are undisputed that ASARCO *"had nothing to do"* with Bendix's business in an operational sense. Stip. ¶ 62 (J.A. 169) (emphasis added). Accordingly, Bendix's investment in ASARCO cannot be characterized as serving

an "operational function" rather than an "investment function."

No doubt when, as in *Container*, a parent makes non-arm's-length loans to a subsidiary to assure the subsidiary's continuing growth or, in *Corn Products*, when a corn products manufacturer invests in corn futures to assure itself of stable prices for its inventory, the investments are fairly described as "operational" and the income therefrom may be apportioned along with the rest of the income from the taxpayer's business operations. Indeed, the same may be said of many of Bendix's investments in operating companies that enhanced its core businesses. See pp. 30-31, *supra*. But these examples of capital transactions serving an "operational function" have nothing in common with Bendix's minority investment in a company in an unrelated line of business with which Bendix had no functional relationship. Such an investment was aptly described by *Container* itself as an "[i]nvestment in a business enterprise truly 'distinct' from a corporation's main line of business... [which] serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle." *Container*, 463 U.S. at 178.

E. Allowing the New Jersey Opinion to Stand Would Undermine Fundamental Principles of Constitutional Adjudication and Deprive Multistate Corporations of Meaningful Protection From State Taxation of Investment Income

The mischievous effect of the decision below is not limited to the fact that, if left to stand, it would leave in shambles the principles articulated by this Court in *ASARCO* and *Woolworth*. The collateral consequences of

abandoning these principles would be no less pernicious. One immediate casualty would be the doctrine of *stare decisis*, which this Court has recognized to be "of fundamental importance to the rule of law," *Welch v. Texas Dep't of Highways and Pub. Transp.*, 483 U.S. 468, 494 (1987). See also *Hilton v. South Carolina Pub. Ry. Comm'n*, No. 90–848 (decided December 16, 1991), 60 USLW 4056, 4057, emphasizing "the central importance of *stare decisis* in this Court's jurisprudence."[16] Another casualty would be the existence of meaningful limitations on the states' power to tax the investment income of multistate corporations. The investment income derived by multistate businesses as a result of the rash of acquisitions and divestitures that characterized the American financial markets during the 1980s would become fair game for any state that could claim to identify an "ingrained corporate strategy" that drove the investment decision. This would be true regardless of the connection between the taxpayer's investment and its activities in the taxing state.

Moreover, if the New Jersey court's attempt to extend state taxing powers far beyond the limits heretofore countenanced by this Court were left undisturbed, it would not merely undermine the essential principles of fairness and constitutional restraint on which this Court's unitary business precedents are so soundly based. It

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[16] While this Court has always recognized that *stare decisis* is somewhat less dominant in matters of constitutional interpretation than in matters of statutory interpretation, here there is no plausible reason why a retreat from the principles the Court articulated in the 1980s should be considered. Those cases were fully argued, the opinions carefully explored the relevant issues, and the results reached were a model of fairness and balance under the Constitution. The principles expressed therein should be reconfirmed and reinforced, rather than be subjected to the substantial inroads which New Jersey is seeking to achieve.

would also leave the law in this area in a state of virtual chaos. The latter consequence would be particularly deplorable in light of the significant increase in the scope and size of corporate diversification, which underscores the need for clear and consistent constitutional guidelines from this Court for tax issues raised by cases like this one. Such guidance is essential, in the modern economic setting, to prevent drastic harm from being inflicted on what otherwise would be unchecked and overzealous efforts on the part of the states to make substantial additions to their sources of revenue without regard to the applicable constitutional limitations.

ASARCO and *Woolworth* struck a reasonable balance between two competing concerns: the states' legitimate demands for income tax revenues from income-generating activities to which the states accord some benefit, and taxpayers' legitimate demands for protection from state taxing authorities who seek to tax income with which the taxing state has no palpable connection. Unless the New Jersey court's assault on the sound considerations underlying *ASARCO* and *Woolworth* is rebuffed, multistate business will be stripped of real protection from unrestrained state taxation of investment income.

CONCLUSION

The judgment of the Supreme Court of New Jersey should be reversed with instructions to exclude Bendix's gain from the sale of its ASARCO stock from Bendix's New Jersey apportionable tax base.

January 1992

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APPENDIX

Comparison of the Facts of This Case with the Facts of *ASARCO* and *Woolworth*

ASARCO and Woolworth were more closely connected to their respective subsidiaries than Bendix was to ASARCO:

- **Ownership**

ASARCO	ASARCO owned about 51.5% of Southern Peru Copper Corp., about 53% of M.I.M. Holdings, Ltd., about 34% of General Cable Corp. and Revere Copper and Brass, Inc., and 49% of Mexicana, S.A. (*ASARCO*, 458 U.S. at 309-10).
Woolworth	Woolworth owned 100% of F.W. Woolworth GmbH (Germany), F.W. Woolworth, Ltd. (Canada), and F.W. Woolworth S.A. de C.V. Mexico, and 52.7% of F.W. Woolworth Co., Ltd. (England) (*Woolworth*, 458 U.S. at 356-57).
Bendix	Bendix owned 20.6% of ASARCO. Stip. ¶ 51 (J.A. 167).

- **Control**

ASARCO	ASARCO's majority interest, if asserted, could enable it to control the management of Southern Peru, although ASARCO did not actually control Southern Peru;

ASARCO had the potential to control M.I.M., but there was no claim that it had done so; General Cable, Revere Copper, and Mexicana operated independently of ASARCO, despite ASARCO's substantial ownership interests in those companies (*ASARCO*, 458 U.S. at 321-24).

Woolworth — Woolworth elected all of the directors of its three wholly owned subsidiaries and potentially had the authority to operate its subsidiaries as integrated divisions of a single unitary business; Woolworth exercised this control with respect to major financial decisions such as the amount of dividends to be paid and the creation of substantial debt, but not with respect to other matters. (*Woolworth*, 458 U.S. at 362-69).

Bendix — Bendix's 20.6% investment in ASARCO did not put it in a position to exercise control over ASARCO, and Bendix did not assert any control. Stip. ¶ 54 (J.A. 168).

- **Line of Business**

ASARCO — ASARCO's investments were all in companies engaged in essentially the same line of business as

it was—mining, smelting, and refining of nonferrous metals (Southern Peru, copper production; M.I.M. Holdings, mining, milling, smelting, and refining of nonferrous metals; General Cable and Revere Copper, fabrication of metal products; Mexicana, mining and smelting lead and copper) (*ASARCO*, 458 U.S. at 320-24).

Woolworth — Woolworth's investments were all in companies engaged in precisely the same line of business—chain store retailing (*Woolworth*, 458 U.S. at 356-57).

Bendix — Bendix's investment was in a company admittedly engaged in an unrelated line of business. Stip. ¶ 41 (J.A. 164–65).

- **Functional Integration**

ASARCO — Southern Peru sold 35% of its copper output to ASARCO; M.I.M. Holdings sold 1% of its output to ASARCO and used an ASARCO melting furnace patent; General Cable purchased approximately 6% of ASARCO's output and ASARCO purchased approximately 0.1% of General Cable's output; Revere Copper purchased approximately 3-4% of

	ASARCO's output, and ASARCO purchased approximately 1-2% of ASARCO's output; ASARCO sold Mexicana insignificant amounts of its output and acted as a contract sales agent for Mexicana in the United States (*ASARCO*, 458 U.S. at 321-24).
Woolworth	There was little functional integration, although there was irregular in-person and frequent mail, telephone, and teletype communication between upper echelons of management of the parent and the subsidiaries (*Woolworth*, 458 U.S. at 364-69).
Bendix	There was no functional integration. Stip. ¶¶ 41, 62 (J.A. 164–65, 169–71); pp. 7-9, *supra*.

Supreme Court, U.S.
FILED
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No. 91-615

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL, INC.
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari
To The Supreme Court Of New Jersey

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QUESTION PRESENTED

Whether the unitary business principle permits a state to tax a nondomiciliary corporation on a portion of the capital gain derived from a minority stock interest when, as here, the stock is integral to the corporation's operational and financial strategies but there is no unitary relationship between the corporation and the issuer of the stock.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

COUNTERSTATEMENT OF THE CASE 1

A. Origins of the Controversy 1

B. Overview of Bendix 2

C. Bendix' Acquisitions and Divestitures 4

D. Bendix' Centralized Management 7

E. Purchase of ASARCO Stock 8

F. Holding of ASARCO Stock 10

G. Sale of ASARCO Stock 11

H. New Jersey's Corporation Business Tax 12

I. The Decision Below 15

SUMMARY OF ARGUMENT 16

ARGUMENT:

THE NEW JERSEY SUPREME COURT PROPERLY HELD THAT THE ASARCO GAIN WAS APPORTIONABLE INCOME BECAUSE BENDIX CONDUCTED PART OF ITS UNITARY BUSINESS IN NEW JERSEY AND THE ASARCO STOCK INTEREST WAS AN INTEGRAL PART OF THAT BUSINESS 19

A. The New Jersey Supreme Court's Analysis Was Consistent With The Court's Traditional Approach To the "Unit" Rule 19

1. Function of The Unitary Business Principle 19

TABLE OF CONTENTS – Continued

Page

2. Historically, The Court's Unitary Business Cases Have Focused On The Activities Of The Taxpayer To Determine The Scope Of The Unitary Business 20

B. The Record Establishes That There Was A Unitary Relationship Between Bendix' Operations And The ASARCO Stock Interest 24

1. The Purchase and Sale of the ASARCO Stock Were Functionally Related to Bendix' Unitary Business 24

2. The Purchase and Sale of the ASARCO Stock Were Essential to the Financial Management of Bendix' Unitary Business 28

3. The ASARCO Stock Interest and Bendix' Ongoing Operations Were Linked by Strong Centralized Management 28

4. The ASARCO Stock Interest Was Not a Passive Investment 30

C. Common Sense and Economic Reality Require That The ASARCO Gain Be Treated As Unitary Income 32

1. Petitioner's Understanding of the Unitary Business Principle Cannot Be Squared With the Accepted Treatment of Working Capital Investments 32

2. Petitioner's Theory of the Unitary Business Principle As Applied In This Case Is Inconsistent With Economic Reality 36

TABLE OF CONTENTS – Continued

Page

D. The Court's Holdings In *ASARCO* And *Woolworth* Do Not Preclude New Jersey From Taxing A Share Of The ASARCO Gain, But The Court's Broad Language In *ASARCO* Should Be Qualified 37

1. The Record Distinguishes this Case from *ASARCO* and *Woolworth* 38

2. New Jersey's Argument Is Not One Of Amorphous Corporate Purpose 41

3. The Court Should Make Clear That Intercorporate Relationships Are Not the Exclusive Indicia Of A Unitary Business, But It Need Not "Abandon" *ASARCO* Or *Woolworth* 43

4. *Container* Supports New Jersey's Position ... 47

E. Petitioner's Proposed Tax Exemption Would Be Unfair To The States And Unnecessary To Protect Interstate Business 49

CONCLUSION 50

TABLE OF AUTHORITIES

Page

Cases Cited

Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 21

Albany Int'l. Corp. v. Halperin, 388 A.2d 902 (Me. 1978) 27

Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. 66 (1989) 27

American Home Products Corp. v. Limbach, 49 Ohio St. 3d 158, 551 N.E.2d 201, *cert. denied sub nom. Limbach v. American Home Products Corp.*, 111 S.Ct. 63 (1990) 33

American Trucking Associations, Inc. v. Scheiner, 483 U.S. 266 (1987) 36

Arkansas Best Corp. v. Commissioner, 485 U.S. 212 (1988) 35

ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, *reh'g denied* 459 U.S. 961 (1982) ..... *passim*

Bass, Ratcliff & Gretton v. State Tax Comm'n, 266 U.S. 271 (1924) 20, 21

Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932) 47

Butler Bros. v. McColgan, 315 U.S. 501 (1942) 21, 27

Cincinnati, New Orleans & Texas Pacific Ry. v. Ky. Dept. of Rev., 684 S.W.2d 303 (Ky. Ct. App. 1985) 33

Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) 36

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 36

TABLE OF AUTHORITIES – Continued

Page

Container Corp. of America v. Franchise Tax Bd., 463 *U.S.* 159, *reh'g denied* 464 *U.S.* 909 (1983)..... *passim*

Corn Products Refining Co. v. Commissioner, 350 *U.S.* 46 (1955), *reh'g denied* 350 *U.S.* 943 (1956)..... 35

Corning Glass Works, Inc. v. Virginia Dept. of Taxation, 241 *Va.* 353, 402 *S.E.*2d 35, *cert. denied* 112 *S.Ct.* 277 (1991)..... 44

Edelman v. Jordan, 415 *U.S.* 651, *reh'g denied* 416 *U.S.* 1000 (1974)..... 47

Exxon Corp. v. Wisconsin Dept. of Revenue, 447 *U.S.* 207 (1980)..... *passim*

F.W. Woolworth Co. v. Taxation & Revenue Dept., 458 *U.S.* 354, *reh'g denied* 459 *U.S.* 961 (1982)..... *passim*

Gomillion v. Lightfoot, 364 *U.S.* 339 (1960)..... 38

Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 *U.S.* 123 (1931)..... 21

Holiday Inns, Inc. v. Olsen, 692 *S.W.*2d 850 (Tenn. 1985)..... 33

International Paper Co. v. Director, Div. of Taxation, 11 *N.J.* Tax 147 (Tax Ct. 1990), *aff'd.* N.J. Super Ct., App. Div., No. A-5138-89T5 (May 13, 1991), *certif. denied* N.J. Sup. Ct., No. 33,784 (Oct. 18, 1991)..... 43, 44

Lone Star Steel Co. v. Dolan, 668 *P.*2d 916 (Colo. 1983)..... 33

M. Lowenstein Corp. v. S.C. Tax Comm'n, 298 *S.C.* 93, 378 *S.E.*2d 272 (Ct. App. 1989)..... 33

Mobil Oil Corp. v. Commissioner of Taxes, 445 *U.S.* 425 (1980)..... *passim*

TABLE OF AUTHORITIES – Continued

Page

Moorman Mfg. Co. v. Bair, 437 *U.S.* 267 (1978) 19, 49

NCR Corp. v. Comptroller of the Treasury, 313 *Md.* 118, 544 *A.*2d 764 (1988) 33

Northern Nat'l Bank v. Porter Township, 110 *U.S.* 608 (1884) 38

Payne v. Tennessee, 111 *S.Ct.* 2597 (1991) 47

Pittsburgh, Cincinnati, Chicago & St. Louis Ry. v. Backus, 154 *U.S.* 421 (1894) 20

Pledger v. Illinois Tool Works, Inc., 306 *Ark.* 134, 812 *S.W.*2d 101, *cert. denied* 112 *S.Ct.* 418 (1991) 44

Silent Hoist & Crane Co., Inc. v. Director, Div. of Taxation, 100 *N.J.* 1, 494 *A.*2d 775, *cert. denied* 474 *U.S.* 995 (1985) 42

Trinova Corp. v. Michigan Dept. of Treasury, 111 *S.Ct.* 818 (1991) 14, 36

Underwood Typewriter Co. v. Chamberlain, 254 *U.S.* 113 (1920) 20

United States v. Ross, 456 *U.S.* 798 (1982) 47

United States Glue Co. v. Oak Creek, 247 *U.S.* 321 (1918) 21

United States Steel Corp. v. Multistate Tax Comm'n, 434 *U.S.* 452 (1978) 34

W.R. Grace & Co. v. Commissioner of Revenue, 378 *Mass.* 577, 393 *N.E.*2d 330 (1979) 43

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TABLE OF AUTHORITIES – Continued

Page

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I.R.C.

§ 11(a) 49

§ 61(a) 49

§ 63(a) 49

§ 1221 35

Mich. Comp. Laws

§ 208.3(3) 49

§ 208.9 49

N.J. Stat. Ann.

§ 54:10A-2 12

§ 54:10A-4(k) 12

§ 54:10A-4(k)(5) 10, 13

§ 54:10A-5 12

§ 54:10A-5(c) 14

§ 54:10A-6 13

§ 54:10A-8 13

REGULATIONS CITED

Multistate Tax Commission, Reg. IV.1(c)(4) 43

N.J. Admin. Code tit. 18, § 7-11.15 (1991) 13

TABLE OF AUTHORITIES – Continued

Page

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TABLE OF AUTHORITIES – Continued

Page

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COUNTERSTATEMENT OF THE CASE

A. Origins of the Controversy.

This is a unitary business case involving the single issue of whether a state may impose its income-based corporation tax on an apportioned share of the capital gain realized by a nondomiciliary corporation from the sale of a minority stock interest in an unrelated domestic corporation. The case arose when petitioner's predecessor-in-interest The Bendix Corporation filed a complaint in the Tax Court of New Jersey challenging the New Jersey Division of Taxation's denial of its claims for refund of New Jersey corporation business tax ("CBT") for Bendix' 1980 and 1981 fiscal years and an assessment of additional CBT for the 1980 fiscal year (J.A. 3, ¶1).

Bendix claimed that certain capital gains and interest income realized in connection with its sale of stock in various corporations and (for 1981 only) that dividends from ASARCO, Inc. and one other corporation should not have been included in the net income base of the CBT (J.A. 9 to 11, ¶3). Bendix claimed that the inclusion of the income violated the Due Process Clause of the Fourteenth Amendment because there was no unitary business existing between it and the companies in which it had invested and whose stock it had sold (*id.*). Alternatively, Bendix claimed that, if the income were to be included in the tax base, either the Commerce Clause or the New Jersey CBT itself required an adjustment to the three-factor statutory apportionment formula to include the receipts, payroll, and property of the corporations whose stock was sold (J.A. 11, ¶¶3H, 3I).

Subsequently, Bendix dropped its claims respecting the 1980 fiscal year and many of its claims respecting the 1981 fiscal year (including its claim that the dividends from ASARCO were not unitary income), leaving only its 1981 claims that (1) the State of New Jersey could not include in the income base the capital gains realized on the sale of Bendix' 20% stock interest in ASARCO and its 100% stock interest in United Geophysical Corporation, nor the interest income earned on the proceeds of those sales, and (2) its alternative claim to factor relief (J.A. 13). In this Court petitioner has limited its appeal to the taxability of the ASARCO gain.

The three New Jersey courts that considered the case concluded, with no dissents, that the capital gains and interest income were realized in the course of Bendix' unitary business and could therefore be included in the tax base, to be apportioned under the statutory formula. All three courts denied the factor relief sought by Bendix on the ground that Bendix had made no showing that the formula operated either unconstitutionally or unfairly under the CBT statute in subjecting approximately 8% of the income in question to tax in New Jersey.[1]

B. Overview of Bendix.

Bendix was incorporated in 1929 as a manufacturer of aviation and automotive parts (J.A. 154, ¶7) and in 1937

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[1] The New Jersey Tax Court noted that, "[T]here is no claim by the taxpayer of double taxation, and there is no evidence that Michigan, the state of Bendix's commercial domicile, has treated the subject income as nonbusiness income" (Pet. App. C at 65a).

received a certificate of authority to do business in New Jersey (*id.*, ¶8). During the period at issue, Bendix' corporate headquarters were in Southfield, Michigan (J.A. *id.*, ¶10). By 1970 Bendix had become a diversified manufacturer having four major operating groups consisting of the automotive group, aerospace group, forest products group, and industrial/energy group (*id.*, ¶11; J.A. 190, ¶148).[2] Bendix concedes that these diverse activities formed a single unitary business for purposes of its 1980 and 1981 New Jersey CBT returns.

During the period at issue, Bendix did business, either directly or through subsidiaries or other units, in all 50 states and 22 foreign countries (J.A. 154, ¶11). Several units in Bendix' aerospace group were based in New Jersey, as well as a unit that manufactured electric power generating systems (J.A. 161 to 162, ¶¶31-36). In addition, Bendix sold the full range of its products to New Jersey customers (J.A. 163, ¶38). There is no dispute that Bendix' activities in New Jersey were part of its unitary business (cf. J.A. 9 to 12, ¶¶3A to 3I).

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[2] As described in Bendix' 1981 Annual Report to Shareholders, the automotive group supplied systems and components for cars and trucks including a variety of replacement parts. The aerospace group provided products and services to the military, commercial, and general aviation markets and for the space program. The industrial/energy group supplied a wide range of machine tools for the metal-working industry and produced heavy-duty equipment and piping systems (J.A. 220). In forest products Bendix was vertically integrated; it owned timber, produced lumber, plywood, moldings, millwork and particleboard, and operated distribution yards catering to retail dealers (J.A. 227 to 230; J.A. 44 to 45).

C. Bendix' Acquisitions and Divestitures.

At least as early as 1965, Bendix began a program of growth and diversification through the acquisition and occasional divestiture of other corporations. In 1965, Bendix bought the stock of United Geophysical Corporation ("UGC") (J.A. 172, ¶69). According to its 1965 Annual Report to Shareholders, Bendix was accelerating its acquisitions program with the intent not only to diversify but also to achieve a better balance between its military and nonmilitary sales. UGC's business, seismic surveying, was thought to be complementary to Bendix' oceanic endeavors (*id.*, ¶70; J.A. 173, ¶¶71,73).

In the years subsequent to 1965, Bendix' acquisitions and dispositions continued:

- **1966** – seven acquisitions (J.A. 184, ¶132).
- **1967** – five acquisitions; disposition of the marine division (J.A. 185 to 186, ¶¶133, 134).
- **1968** – five acquisitions (*id.*, ¶135).
- **1969** – six acquisitions; three dispositions (J.A. 187, ¶¶137, 138).
- **1970** – one acquisition (Bendix' largest to date) (J.A. 188, ¶139; J.A. 184, ¶130; J.A. 154 to 155, ¶¶11, 13).
- **1971** – six small acquisitions plus a 50% interest in two European companies (J.A. 188, ¶140).
- **1973** – two acquisitions plus the Autolite spark plug manufacturing facility and the Autolite trademark from the Ford Motor Company (*id.*, ¶142).

- **1977** – one acquisition (J.A. 190, ¶129).
- **1978** – three acquisitions plus 20% of the shares of ASARCO (Bendix' largest purchase to date); disposition of a portion of Bendix Home Systems (*id.* ¶¶149, 150).
- **1979** – two acquisitions (J.A. 191, ¶152).
- **1980** – acquisition of a machine tool manufacturer for $300.7 million (Bendix' largest acquisition to date); one disposition (*id.*, ¶153).
- **1981** – disposition of the entire forest products group including Bendix Forest Products Corporation, Bass & Company, Caradco, and Modern Materials; disposition of UGC; disposition of Bendix' interest in ASARCO (J.A. 192, ¶156), for total net cash of approximately $700 million (J.A. 136).
- **1982** – unsuccessful tender offer for 70% of the shares of Martin Marietta Corporation for a total of $1.5 billion (J.A. 193, ¶162; J.A. 82). Allied acquired a majority of Bendix' shares (J.A. 194, ¶¶164, 165).

The foregoing acquisitions ranged over a variety of industries, some related to Bendix' existing businesses and others in unrelated areas such as seismic surveying (J.A. 173, ¶¶71, 73), fiber optics (J.A. 185, ¶132), and, in 1970 (the year in which Bendix acquired the American Forest Products Company), forest products (J.A. 184, ¶130; J.A. 45 to 46). The acquisitions increased steadily in size. The major dispositions in 1981 were followed in 1982 by the tender offer for Martin Marietta.

Over this period, Bendix' Annual Reports to Shareholders continually stressed the objective of diversification to protect the company against downturns in any one segment of its business (J.A. 172, ¶70; J.A. 186, ¶136; J.A. 188, ¶141; J.A. 189, ¶147; J.A. 192, ¶158). In 1969, the company's chairman pointed out that Bendix' growth during the prior 10 years had been achieved in large part through acquisitions (J.A. 187, ¶136), and that trend continued through 1979. Some of the acquisitions were obviously consistent with Bendix' strategic goals for each major operating group. For instance, the acquisition of Coin Millwork, a manufacturer of wood moldings, was consistent with the company's strategic goal for the forest products group of integrating forward in the distribution chain (J.A. 190, ¶147; J.A. 160, ¶29; J.A. 184, ¶129; J.A. 191, ¶152).

The 1980 and 1981 dispositions were part of a major restructuring intended to concentrate the company more intensively on the high technology aspects of its business (J.A. 191, ¶154; J.A. 59 to 60). Implementing this shift in strategy, Bendix began to sell its noncore businesses (J.A. 191, ¶153; J.A. 56), specifically those included in its natural resources group (J.A. 191, ¶155), purchased stock in high technology businesses, formed a technical ventures group, established an Advanced Technology Center, and established within the Bendix planning department a screening program to select a major acquisition candidate in a high technology business (J.A. 191, ¶154; J.A. 160, ¶30; J.A. 77 to 78).[3] The screening program lasted for nearly two years and led to the selection of Martin Marietta Corporation as the target (J.A. 160, ¶30).

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[3] Bendix acquired 7% of RCA's stock, not 70%.

The proposed acquisition of Martin Marietta was consistent with the company's long-term goal for the aerospace group of moving into the production of entire systems and subsystems rather than remaining a subcontractor of component parts (J.A. 80 to 81; J.A. 160, ¶29; J.A. 194, ¶163; J.A. 265) and would have insulated Bendix from excessive exposure to the automotive market (J.A. 268 to 269).

D. Bendix' Centralized Management.

In January 1977, William M. Agee became chief executive officer of Bendix and remained in that position until June 1983 (J.A. 156, ¶15). During this period Agee had direct input into the corporation's operations, particularly its acquisitions and divestitures.[4]

Every year, each operating unit and subsidiary prepared a five year strategic plan, which described the business outlook for the particular entity involved and, in some cases, discussed acquisition and divestiture possibilities (J.A. 158, ¶24). Each such plan was reviewed at the major operating group level. The Bendix planning department reviewed each major group's plan, and subsequently each plan was reviewed by Agee and others prior to being incorporated into the corporate-wide strategic plan for that year (*id.*, ¶25).

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[4] As to Agee's involvement in ongoing operations, see J.A. 17, 25-26, 40; as to his involvement with acquisitions and divestitures, see J.A. 42, 57, 60, 35, 50, 86, 80, 68-69.

Besides its role in the ongoing review of Bendix' strategic plans, the Bendix planning department developed long and short range business proposals for the corporation. These efforts included the evaluation of acquisition candidates (J.A. 159, ¶27).

E. Purchase of ASARCO Stock.

Bendix began planning for the acquisition of a natural resources company in the spring of 1977. In April of that year, Agee received a memorandum from the Bendix planning department presenting a survey of natural resource companies (J.A. 231 to 232). The memorandum notes that natural resource companies tend to be countercyclical to the overall economy and would "offer Bendix an opportunity for diversifying" (J.A. 233).

At the end of March 1978, Agee presented to the long-range planning committee of the Bendix Board a memorandum, authored by Jerome Jacobson, head of the company's planning department, with input by Agee, on long-range growth and acquisition planning for the company (J.A. 165, ¶44; J.A. 87). According to Jacobson and Agee, the company's financial and managerial strength "warrant several major moves aimed at growth and diversification for the 80's," including "investment in other basic resources that are now depressed and undervalued but that offer strong profit possibilities for the 80's" (J.A. 87). The reasons for acquiring a copper mining company, such as ASARCO, include their undervaluation (J.A. 93) and the threat of worldwide shortages in basic commodities (J.A. 95), including copper (J.A. 98). The authors state that they favor acquiring 20% rather than a

majority or 100% of ASARCO's shares because the smaller financial commitment will permit Bendix to complete its other acquisitions in forest products and industrial energy, and a 20% position will give Bendix "time to become more familiar with the company and the industry before chancing a significantly larger position" (J.A. 104). According to Jacobson and Agee, Bendix will seek representation on ASARCO's Board to gain information about the company and the industry preparatory to deciding "whether to enlarge or sell our holdings" (J.A. 107 to 108).

The long-range planning committee approved the acquisition of a 20% interest in ASARCO, and on April 13, 1978, Agee requested approval from the Bendix Board to make the acquisition (J.A. 166, ¶¶46, 47). Agee asserted that the acquisition would reduce Bendix' dependence on the slower growing areas of its business, such as aerospace, would generate good cash flow "to meet growing capital needs, particularly in aerospace/electronics," and would broaden Bendix' holdings of basic commodities including forest products and non-fuel minerals (J.A. 120).

The Bendix Board approved the acquisition of up to 21% of the common stock of ASARCO at a price not to exceed $134 million (J.A. 166, ¶49). The stock purchase agreement provided that ASARCO would recommend the election of William Agee and a Bendix outside director to ASARCO's Board (J.A. 168, ¶53).

Ultimately, Bendix acquired 20.6% of ASARCO's stock for a total purchase price of $127.6 million (J.A. 167, ¶¶51, 52). Approximately $17.5 million of the purchase

price derived from internally generated funds, while the balance was borrowed (*id.*, ¶52).[5] There is no evidence in the record to indicate that Bendix did not deduct the interest incurred on these borrowed funds as an expense of its unitary business on its New Jersey CBT returns.

F. Holding of ASARCO Stock.

Agee and the Bendix planning department's analysis of the worldwide copper industry and of ASARCO's potential proved to be accurate. Bendix' financial statements show that ASARCO contributed 82 cents per share to Bendix' 1979 earnings per share of $7.10 and approximately $2.22 per share to Bendix' 1980 earnings per share of $7.68 (J.A. 169, ¶¶59, 60).[6]

In September 1979, with the backing of the Bendix Board, Agee made a proposal to the ASARCO Board that the two companies merge. ASARCO rejected the proposal (J.A. 169, ¶61).

During the period that Bendix held 20.6% of the stock of ASARCO, the only contacts between the operations of Bendix and the operations of ASARCO were the presence of Messrs. Agee and Baldridge on ASARCO's Board (J.A.

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[5] The $17.5 million in internally generated funds presumably derived from the divestment of other entities (J.A. 131 to 132; J.A. 190, ¶149).

[6] Bendix' share of ASARCO's earnings was *not* taxed by New Jersey. The earnings contribution was for financial reporting purposes only. For New Jersey tax purposes, Bendix reported 50% of the ASARCO dividends in the preapportionment tax base. N.J. Stat. Ann. § 54:10A-4(k)(5) (West 1986).

168, ¶53), a minute amount of sales by ASARCO subsidiaries to Bendix (J.A. 170, ¶62), and quarterly reviews of ASARCO's books to enable Bendix to report the ASARCO investment on the equity method of accounting (J.A. 168, ¶56).

G. Sale of ASARCO Stock.

The sale of Bendix' interest in ASARCO in 1981 for $335.9 million (J.A. 172, ¶¶66, 67) was part of a major restructuring of the company, which was intended to eliminate Bendix' noncore businesses, reduce the company's dependence on the automotive industry, and focus the company more intensively in high technology areas (J.A. 63 to 78; J.A. 65; J.A. 70 to 72; J.A. 171, ¶64; J.A. 191, ¶¶154, 155). According to Agee, the greater focus on high technology businesses was motivated by a combination of factors — higher expected returns, a safer, more secure position for the company and its employees, a sense that the noncore businesses did not fit the long-term strategy of the company, and a concern that their future returns would not compare favorably with their immediate prior returns or to the potential return from selling the businesses and investing the proceeds in marketable securities (J.A. 72; J.A. 76 to 77).

The ASARCO stock sale and other divestitures generated net cash proceeds of approximately $700 million (J.A. 136), which were invested in highly liquid, interest bearing obligations with maturities of less than 90 days (J.A. 181, ¶117; J.A. 182, ¶123).[7] The cash was thus readily

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[7] In the spring of 1981, Bendix purchased approximately four million of its own shares for a total price of $257.5 million (J.A. 182 to 183, ¶¶124, 126, 127).

available in the event Bendix determined to make an acquisition (J.A. 70 to 71) and was in fact instrumental in Bendix' attempt to acquire Martin Marietta Corporation in the summer of 1982 (J.A. 193, ¶161; J.A. 81; J.A. 136).

H. New Jersey's Corporation Business Tax.

New Jersey's corporation business tax is a franchise tax that was measured during the years at issue by a tax on net worth (essentially book equity)[8] and a tax on net income. *N.J. Stat. Ann.* § 54:10A-2 ("*N.J.S.A.*"); *N.J.S.A.* 54:10A-5. The income measure, which was added to the statute in 1958, 1958 *N.J.Laws, c.* 63, is based upon "entire net income" defined as federal taxable income before the net operating loss deduction and special deductions. *N.J.S.A.* 54:10A-4(k). Unlike the majority of states, New Jersey does not distinguish between so-called business income and nonbusiness income.[9] Ever since the enactment of the income measure in 1958, all income, subject to constitutional constraints, has been included in the net income base. Dividends from subsidiaries owned to the extent of 80% or more are excluded from the base, while dividends from all other corporations are excluded to the

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[8] The net worth measure was repealed in 1985. 1985 *N.J.Laws, c.* 55.

[9] See the *amicus* brief of the State of California filed in support of New Jersey for a discussion of business income and the unitary business principle. *See also* Peters, "What Is Nonbusiness Income?,-Part I," 1 *State Tax Notes* 511 (Dec. 1991) and Peters "What Is Nonbusiness Income?,-Part II," 2 *State Tax Notes* 13 (Jan. 1992).

extent of 50%. *N.J.S.A.* 54:10A-4(k)(5). Corporations that maintain "a regular place of business outside [the] State" are permitted to apportion their entire net income using the standard three-factor apportionment formula, which averages the ratios of in-state property, payroll, and receipts to total property, payroll, and receipts. *N.J.S.A.* 54:10A-6. Apportionment is available to all corporations, whether domestic or foreign, and as to all income, whether operating income or investment income. Under *N.J.S.A.* 54:10A-8, a taxpayer's apportionment factor may be adjusted in order to achieve a fair apportionment of income to the State. Finally, New Jersey does not permit or require combined reporting, *i.e.*, the combination of income and apportionment factors of related corporations conducting a unitary business. *N.J. Admin. Code* tit. 18, § 7-11.15 (1991) (Dal).[10]

These statutory provisions produced the following results:

– Although constitutionally permissible, the income of Bendix and the income of its functionally integrated, controlled subsidiaries were not included in a combined report. *Cf. ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 *U.S.* 307, 312, *reh'g. denied* 459 *U.S.* 961 (1982); *Container Corp. of America v. Franchise Tax Bd.*, 463 *U.S.* 159, 168, *reh'g. denied* 464 *U.S.* 909 (1983).[11]

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[10] The designation "D-" refers to the appendix attached to this brief.

[11] The *Container* case involved combined reporting as applied by California. Under that methodology the income of

(Continued on following page)

– Bendix conceded that its entire net worth, including the value of the ASARCO stock, was apportionable for New Jersey purposes.[12]

– Bendix did not contest the inclusion of 50% of the ASARCO dividends in apportionable net income for the 1977-1980 years and has withdrawn its challenge on this issue for 1981.

– Over Bendix' protest, the New Jersey Division of Taxation included the ASARCO stock gain in apportionable net income, applied Bendix' statutory apportionment factor of approximately 8% (J.A. 154, ¶5) and then the CBT tax rate of 9%. *N.J.S.A.* 54:10A-5(c).

Petitioner insists that this single aspect of the ASARCO stock interest -- the gain on sale -- is beyond New Jersey's taxing power such that the state tax,

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(Continued from previous page)

separate, majority owned, unitary affiliates is included in the income base subject to apportionment, while intercorporate transactions such as dividends from subsidiary to parent are eliminated. The apportionment factor of each member of the unitary group compares the property, payroll, and receipts within the taxing state of that member to the total property, payroll, and receipts of the group. *Container* at 168, n.5, 174; *see* Peters, "Supreme Court's *Mobil* Decision on Multi-state Income Apportionment Raises New Questions," 54 *J. Tax'n* 36, 39 (1980); Keesling and Warren, "The Unitary Concept In The Allocation of Income," 12 *Hastings L. J.* 42, 60-61 (1960); Hellerstein, *State Taxation I Corporate Income and Franchise Taxes* ¶8.12 (1983).

[12] The unitary business principle applies to taxes other than income taxes. *See e.g. Trinova Corp. v. Michigan Dept. of Treasury*, 111 *S.Ct.* 818 (1991) (value added tax).

amounting to .72% (8% x 9%) of the total gain of $211 million, cannot constitutionally be imposed.

I. The Decision Below.

The Supreme Court of New Jersey held that the ASARCO stock gain was apportionable because Bendix "had a business function of corporate acquisitions and divestitures that was an integral operational activity" (Pet. App. A at 18a to 19a). The court reasoned:

> The tests for determining a unitary business are not controlled by the relationship between the taxpayer recipient and the affiliate generator of the income that becomes the subject of State tax. . . . [T]here is no bright line controlling test. What controls is the underlying activities that reflect the economic realities of the corporate business (*id.* at 18a).

Significant to the court's analysis were the role of the sale of the ASARCO stock in Bendix' subsequent attempt to acquire Martin Marietta (*id.* at 7a, 9a to 11a, 20a) and the central role played by Bendix' chairman William Agee (*id.* at 4a, 5a, 10a to 11a). Bendix' sale of its interest in ASARCO and its tender offer for Martin Marietta were, the court indicated, two steps in "an ingrained acquisition-divestiture policy designed to expand and enhance [Bendix'] existing operations as well as to move it into other fields of business" (*id.* at 18a). Bendix' "acquisition-divestiture policy" was not simply a means of diversifying into areas "distinct from the corporation's main line of business" but was itself a business function (*id.* at 18a to 19a). On this basis, and on the differing factual records,

the New Jersey Supreme Court distinguished this Court's opinion in *ASARCO* (*id.* at 21a).

SUMMARY OF ARGUMENT

New Jersey may tax an apportioned share of the ASARCO stock gain because the acquisition, holding, and sale of the stock were integrally related to Bendix' concededly unitary business. Since the ASARCO stock interest was itself integrally related to Bendix' unitary business, there is no need to show a unitary relationship between the operations of Bendix and the operations of ASARCO. The unitary relationship between the ASARCO stock interest and Bendix' otherwise unitary operations satisfies the unitary business principle and thus the Due Process and Commerce Clauses.

There is no hard and fast definition of a unitary business, but in its latest decision on the subject, the Court declared that a unitary relationship between a corporation's in-state and out-of-state activities exists if there is a concrete relationship between the in-state and out-of-state activities producing a flow of value that is more than a flow of funds from a passive investment or a discrete business. *Container*, 463 *U.S.* at 166.

The record facts establish a sufficient "sharing or exchange of value" between Bendix' unitary business and the ASARCO stock interest to conclude that the ASARCO gain was earned in the course of Bendix' unitary business:

1. Diversification and growth through acquisitions were central to Bendix' longstanding operational strategy for overall corporate profitability, and the ASARCO stock purchase and sale were part of that strategy. *Container*, 463 *U.S.* at 180, n.19.

2. The ASARCO stock purchase and sale were intended to meet and did meet the financial needs of Bendix' unitary business. *ASARCO*, 458 *U.S.* at 337 (O'Connor, J., dissenting). The ASARCO investment was made in part to generate cash to meet the needs of Bendix' core businesses, and the cash proceeds from the ASARCO stock sale in fact created the additional cash and debt capacity that Bendix needed to make a major acquisition in the aerospace industry.

3. Bendix benefitted from "strong centralized management and controlled interaction," *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 *U.S.* 207, 224 (1980), that linked the ASARCO stock interest and Bendix' unitary business. That link is most evident in the "hands-on" involvement of Bendix' chairman/CEO William Agee and the Bendix planning department in the acquisition, holding, and disposition of the ASARCO stock.

4. The ASARCO stock generated more than a flow of funds to Bendix from a passive investment. Bendix used its substantial minority interest to gain two seats on ASARCO's Board and thereby acquire knowledge of ASARCO's business and the nonferrous metals industry before chancing a larger, controlling interest, an interest that Bendix briefly sought to attain.

There is little dispute that income earned on short-term investments of working capital is apportionable

without regard to the business relationship between the issuer and the recipient. The reason that such investments are unitary and therefore apportionable is that they are integrally connected with the recipient's business operations. Stock investments may be just as related to a taxpayer's unitary business as the short-term investment of its working capital albeit the relationships, as here, may take a different form. As the Court made clear in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 *U.S.* 425, 440 (1980), the form of the investment should not determine whether it is or is not unitary. Investments can be as much a part of a corporation's unitary business as its traditional manufacturing activities. Bendix' chairman/CEO viewed the corporation as "pools of assets," consisting variously of Bendix' manufacturing businesses and a portfolio of investments (J.A. 133 to 137).

A majority of the Court has not recognized the apportionability of investment income based on the integration of an investment with a corporation's otherwise unitary business, but the Court has not previously been presented with facts to support such a holding. There were no record facts in either *ASARCO* or *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 *U.S.* 354 (1982), linking the corporations' *investments* in their subsidiaries to the operations of the parent companies. Here those facts are present and serve to distinguish both *ASARCO* and *Woolworth*.

ASARCO and *Woolworth* thus do not preclude New Jersey's apportioned taxation of the ASARCO gain. However, the Court should qualify the majority's broad statement in *ASARCO* that, absent a unitary link between the

payor of dividend income and the recipient, a non-domiciliary state may not apportion dividend income. *ASARCO*, 458 *U.S.* at 327. The ultimate question in a case involving the includability of income in the unitary tax base, be it sales income or investment income, is whether the *taxpayer's* activities that generated the income are integrally related to the taxpayer's unitary business. A unitary relationship between the payor of investment income and the recipient is relevant because it may evidence the necessary integration of the *investment* with the taxpayer's business, but it is not the only way of establishing that integration. *Id.* at 335-39 (O'Connor, J., dissenting); *Container*, 463 *U.S.* at 179.

ARGUMENT

THE NEW JERSEY SUPREME COURT PROPERLY HELD THAT THE ASARCO GAIN WAS APPORTIONABLE INCOME BECAUSE BENDIX CONDUCTED PART OF ITS UNITARY BUSINESS IN NEW JERSEY AND THE ASARCO STOCK INTEREST WAS AN INTEGRAL PART OF THAT BUSINESS.

A. The New Jersey Supreme Court's Analysis Was Consistent With The Court's Traditional Approach To the "Unit" Rule.

1. Function of the Unitary Business Principle.

"The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate business." *Moorman Mfg. Co. v. Bair*, 437 *U.S.* 267, 272-73 (1978). First, the taxpayer must conduct some part of its activities in the taxing state, and, second, the income attributed to the state must be rationally related

to the in-state values of the enterprise. *Id.*; *Mobil*, 445 *U.S.* at 437. The same restrictions apply under the Commerce Clause. *Container*, 463 U.S. at 164; *ASARCO*, 458 *U.S.* at 327, *n.*23.

In the case of a corporation operating in more than one state, it is extremely difficult to determine the amount of income earned within the taxing state and thus subject to its taxing power. The paradigm is a vertically integrated company that manufactures goods in one state, sells them in another, and has its corporate headquarters in yet another. *See, e.g., Underwood Typewriter Co. v. Chamberlain*, 254 *U.S.* 113, 120 (1920); *Bass, Ratcliff & Gretton v. State Tax Comm'n*, 266 *U.S.* 271, 281-282 (1924); *Mobil*, 445 *U.S.* at 438; *Exxon*, 447 *U.S.* at 210. The unitary business principle attempts to solve the problem by determining the scope of the entire unitary business both within and without the state and apportioning the result by means of a formula reflecting the portion of the total business conducted within the taxing state. *Container*, 463 *U.S.* at 165.

2. Historically, The Court's Unitary Business Cases Have Focused On The Activities Of The Taxpayer To Determine The Scope Of The Unitary Business.

The "unit" rule was developed in the context of state property taxation of railroad and telegraph companies. The entire system was considered a "unit" and a formula (such as the ratio of in-state miles of track to total track) was applied to determine the taxing state's share of total value. *Pittsburgh, Cincinnati, Chicago & St. Louis Ry. v. Backus*, 154 *U.S.* 421 (1894); *Western Union Teleg. Co. v.*

Taggart, 163 *U.S.* 1 (1896). The rule was extended to a capital stock tax on a company lacking the "physical unity" of a railroad in *Adams Express Co. v. Ohio State Auditor*, 165 *U.S.* 194, 221 (1897), with the Court stating, "Presumptively all the property of the corporation . . . is held and used for the purpose of its business . . . " *Id.* at 227. *See also Wallace v. Hines*, 253 *U.S.* 66 (1920) (excise tax measured by value of capital stock, apportioned according to the ratio of in-state track mileage to total track mileage). In *United States Glue Co. v. Oak Creek*, 247 *U.S.* 321 (1918), the Court upheld a state tax on corporate income apportioned on the basis of in-state property and receipts compared to total property and receipts and in *Underwood*, upheld a net income tax apportioned on the basis of a single factor.

In none of these early cases was there any suggestion that the property, capital stock, or income of anyone other than the taxpayer should be considered in determining the "unit."

Later cases applied the same theory to differing kinds of businesses, in each case referencing only the taxpayer's business activities. *Bass, Ratcliff & Gretton, supra* (apportionment of operating income of foreign corporation upheld despite current year loss in taxing state); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 *U.S.* 123, 133 (1931) (striking down apportionment formula but affirming that a manufacturing business is generally unitary and that, "all the factors in [the] enterprise are essential to the realization of profits." *Id.* at 133); *Butler Bros. v. McColgan*, 315 *U.S.* 501, 509 (1942) (geographically divisionalized wholesaler operated unitary

business due to common ownership, centralized management, and economies of scale, and taxpayer failed to show "that income unconnected with the unitary business [had] been used in the formula." *Id.* at 509); *Exxon* (centrally managed, integrated petroleum company conducted unitary business despite its ability to source production and refining income to locations outside taxing state).

In *Mobil*, the Court dealt for the first time with non-operating income, specifically dividends from foreign subsidiaries and ARAMCO, a 10%-owned affiliate doing business abroad. Rejecting Mobil's argument that it was operating a separate holding company business in managing its subsidiaries, the Court concluded that:

> So long as dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business. [*Mobil*, 445 *U.S.* at 440].

Lacking direct evidence linking Mobil's subsidiary investments to its operating business,[13] the Court based its conclusion on the unitary relationships between Mobil

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[13] The record before the Court included the transcript of a hearing before the Vermont Commissioner of Taxes, most of which was taken up by discussions with counsel and legal argument, Mobil's tax returns, an exhibit listing the dividend payors, Mobil's percentage ownership of each, and the amount of dividends from each, and an unsigned stipulation of facts that provided no information as to the integration of Mobil's investments in the subsidiaries with Mobil's petroleum business. *Mobil* App. at A3 to A91.

and its affiliates but left open the possibility that a unitary business could be otherwise established. *Id.* at 435, 442.

Shortly after *Mobil* and *Exxon* were decided, the Court issued its opinions in *ASARCO* and *Woolworth*. In those cases, departing from its consistent, longstanding approach to the unitary business principle, the Court's analysis focused strictly on the relationships between the taxpayer and the payors of dividend income to determine whether the taxpayer's business was unitary. Those decisions are discussed below in Part D. It is sufficient to say here that *ASARCO* and *Woolworth* are not consistent with the Court's earlier unitary business decisions and that much of their force was defused in *Container*, which followed one year later.

In *Container*, returning to the fundamentals of the unitary business principle, the Court made clear that application of the principle entails two steps:

> [F]irst, defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and [second] apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. [463 *U.S.* at 165].

To establish the existence of a unitary business, all that need be shown is a concrete relationship between the in-state and out-of-state activities of the business resulting in:

> [S]ome sharing or exchange of value not capable of precise identification or measurement --

> beyond the mere flow of funds arising out of a passive investment or a distinct business operation — which renders formula apportionment a reasonable method of taxation. [*Id.* at 166].

Indicia of a unitary business include " 'functional integration, centralization of management, and economies of scale;' " *id.* at 179, but a unitary relationship can be shown "in any number of ways," *id.*, and the burden of proof is on the taxpayer to show " 'by clear and cogent evidence' " that there are no unitary relationships linking the in-state and out-of-state activities of the taxpayer. *Id.* at 164.[14]

Under the Court's longstanding application of the unitary business principle, including its most recent articulation of the principle in *Container*, the New Jersey Supreme Court properly analyzed Bendix' activities (not those of ASARCO) to determine the scope of Bendix' unitary business.

B. The Record Establishes That There Was A Unitary Relationship Between Bendix' Operations And The ASARCO Stock Interest.

1. The Purchase and Sale of the ASARCO Stock Were Functionally Related to Bendix' Unitary Business.

Petitioner concedes that all aspects of Bendix' operations -- aerospace/electronics, automotive, industrial/

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[14] In *Container* the unitary relationships were those between Container and its subsidiaries because the "taxpayer" for purposes of a combined report includes separate corporate entities engaged in a single unitary business. *See* above at 13, n. 11 and below at 45, n. 28.

energy, and even forest products — formed a single unitary enterprise. The record establishes that the purchase of the ASARCO stock interest was functionally integrated with that business as a whole.

The purchase served to further diversify Bendix' overall operations, a strategy that had been central to Bendix' operations since at least 1965 (J.A. 233; J.A. 120; J.A. 172, ¶70). In addition, Bendix' management believed that acquisitions were essential for the company's growth in the 1980's (J.A. 187, ¶136), a strategy that had been central to Bendix' historical approach to its operating businesses (J.A. 92). This functional integration did not take the form of, *e.g.* supplying raw materials or markets to Bendix' existing businesses, but there clearly was a "flow of value" to the rest of Bendix' operations in further insulating the company's overall profitability from the cyclical downturns in its core operating areas and fostering the future growth of the company. *See Container*, 463 *U.S.* at 178 and 180, n.19. Bendix' goal of cyclical protection and overall profitability was qualitatively no different than Exxon's search for " 'greater profits stability' " by placing its exploration/production, refining, and marketing divisions " 'under one corporate entity' " to offset economic factors in one department against those in another. *Exxon*, 447 *U.S.* at 225 (quoting the testimony of an Exxon senior vice-president). Exxon may have been using its operating divisions and Bendix a minority stock interest, but functionally they served the same purpose of ensuring overall profitability by insulating the company from downturns in any one segment of its business.

Bendix' sale of its stock in ASARCO was functionally integrated with its core businesses. Carrying out one of

the original goals of the ASARCO stock purchase, Bendix sold the ASARCO stock (along with its other natural resource companies) in part to generate the capital necessary to make a major acquisition of a high technology company. The acquisition target that Bendix selected would have achieved the long-term goal of the aerospace/electronics group of developing the capacity to manufacture entire systems rather than remaining a subcontractor of component parts (J.A. 80 to 81; J.A. 160, ¶29). Additionally, Martin Marietta's emphasis on missiles would have complemented Bendix' emphasis on aviation (J.A. 194, ¶163). Plainly, the ASARCO stock sale was not made simply to " '[add] to the riches of the corporation.' " *Woolworth* at 363, quoting *Wallace v. Hines, supra.* In the words of the New Jersey Appellate Division, the ASARCO stock purchase and disposition were "stepping stones to additional acquisitions" (Pet. App. B at 35a).

In *Container*, the Court reasoned that "capital transactions can serve either an investment function or an operational function." 463 *U.S.* at 180, n.19. Container's loans to its subsidiaries were operational in nature because their purpose was to foster the company's overseas operations. Bendix' use of the ASARCO sale proceeds in its attempt to acquire Martin Marietta similarly served an "operational function" — the growth and profitability of one of Bendix' core businesses. "[T]he resulting flow of value is obvious." *Id.* See Pet. App. A at 20a to 21a.

Petitioner suggests that the use of the ASARCO stock proceeds to further the in-state unitary activities of the taxpayer (here Bendix' aerospace activities in New Jersey)

cannot "establish a due process link between the investment and the state in which the proceeds are subsequently invested" because, at that point, the investment has been sold (Pb36).[15] Petitioner's argument would "eviscerate" the unitary business principle. New Jersey need *not* establish a direct relationship between the ASARCO stock interest and Bendix' aerospace activities in New Jersey. The requisite concrete relationship between Bendix' out-of-state activities (the sale of the ASARCO stock) and Bendix' in-state activities (its aerospace business in New Jersey), *Container*, 463 *U.S.* at 166, results from the fact that both sets of activities are within the scope of Bendix' unitary business. *Id.* at 165; *Amerada Hess Corp. v. Director, Div. of Taxation*, 490 *U.S.* 66, 73 (1989). The question is whether "the out-of-state business activity can be characterized . . . [as] a part of a unitary enterprise doing business in the State." *ASARCO*, 458 *U.S.* at 334 (O'Connor, J., dissenting). If petitioner were correct, the unitary business principle would be a virtual nullity. Ordinary manufacturing/sales income earned in one state may have no direct relationship to the same kind of income earned in another, *e.g.* Bendix' aerospace sales in New Jersey and its forest products sales in other states. The unitary link is created by centralized management, an operational strategy, or other factors, linking the disparate activities. *Cf. Butler Bros., supra*, 315 *U.S.* 501, and *see Albany Int'l. Corp. v. Halperin*, 388 *A.*2d 902, 905 (Me. 1978). Moreover, under petitioner's theory, income realized on the sale of an investment would never be

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[15] The designation "Pb" refers to petitioner's brief on the merits in this Court.

unitary because, by definition, the investment is gone when the income is used in the business.

2. The Purchase and Sale of the ASARCO Stock Were Essential to the Financial Management of Bendix' Unitary Business.

The facts described in the preceding paragraphs indicate as well that the ASARCO stock purchase and sale were part and parcel of Bendix' "management of the financial requirements of its [diversified manufacturing] business." *ASARCO*, 458 *U.S.* at 337 (O'Connor, J., dissenting). One purpose in acquiring what was essentially a large supply of copper was to position Bendix to benefit from an anticipated increase in the world price of copper (J.A. 95 to 100; J.A. 123 to 125). When that anticipation materialized (with the result that Bendix nearly tripled its money in little more than three years), the company was in a position to both supply the needed capital to its aerospace activities and accomplish its long-term goal for that segment of its business of becoming a prime contractor in the aerospace industry. Much like Container's loans to its subsidiaries, the ASARCO stock purchase was part of Bendix' effort to ensure that the company would continue to grow and become more profitable. *Container*, 463 *U.S.* at 180, n.19.

3. The ASARCO Stock Interest and Bendix' Ongoing Operations were Linked by Strong Centralized Management.

In *Exxon*, the foremost factor in the Court's conclusion that Exxon conducted a unitary business was the

company's "highly integrated business which benefits from an umbrella of centralized management and controlled interaction." *Exxon*, 447 *U.S.* at 224; and *see Woolworth*, 458 *U.S.* at 370, contrasting the role of Exxon's "coordination and services management office" with Woolworth's lack of involvement in its subsidiaries' affairs.

Like Exxon's coordination and services office, the Bendix planning department coordinated the company's operational and investment activities. The planning department analyzed business trends to determine where Bendix should increase or decrease its capital investment and its research and development efforts and analyzed areas where Bendix should develop new products, either by developing them from within or through acquisitions (J.A. 159, ¶27). The planning department reviewed each major operating group's five-year strategic plan (J.A. 158, ¶25), which set forth the group's "business prospects, problems and concerns" (J.A. 158, ¶26) including opportunities for growth and in some cases possible acquisitions and divestments (J.A. 158, ¶24). The planning department developed three major strategies for growth, one of which was to move the company "into unrelated areas with strong growth potential" (J.A. 159 to 160, ¶28). As suggested by the New Jersey Appellate Division, the analysis of the ASARCO stock purchase by the Bendix planning department and Agee (J.A. 165, ¶44) demonstrates "the interdependence of Bendix's existing businesses and long-term strategic planning" (Pet. App. B. at 39a). The ASARCO stock acquisition was analyzed from the point of view of Bendix' existing businesses and its effect on Bendix' future growth. *See id.* at 37a to 38a.

During the period at issue, the Bendix chairman William Agee was closely involved with the company's operational and administrative affairs, its long-range planning, and its acquisitions program. The detail with which Agee supervised the company's operations is best exemplified by the fact that in a company having sales exceeding $4.4 billion, Agee approved all capital expenditures exceeding $100,000 (J.A. 211; J.A. 25 to 26). Agee had direct input into the memorandum to the long-range planning committee outlining management's reasons for acquiring an interest in ASARCO (J.A. 165, ¶44). Agee sat on ASARCO's Board, made the proposal to that Board to merge the two companies, and made the decision for Bendix' management to sell the ASARCO stock (J.A. 169, ¶61; J.A. 35). As CEO, Agee determined as well to sell UGC and Bendix Forest Products Corporation (J.A. 57), decided that the proceeds from the various sales should be placed in short-term securities managed by Lehman Brothers in order to ensure the ready availability of cash in the event Bendix "needed the cash to proceed" (J.A. 69 to 70), and made the decision for management to endeavor to acquire Martin Marietta (J.A. 79 to 80).

4. The ASARCO Stock Interest was not a Passive Investment.

The only aspect of the ASARCO stock interest that differentiated it from Bendix' other acquisitions was the lack of control over ASARCO. But the absence of control did not convert the ASARCO stock holding into a

"passive investment"[16] generating no more than a flow of dividends into Bendix' treasury. *Cf. Container*, 463 *U.S.* at 166. As a result of its substantial minority interest, Bendix obtained two seats on ASARCO's Board of Directors (J.A. 168, ¶53). One of the stated objectives for obtaining the Board seats was to learn as much as possible about ASARCO and the nonferrous metals industry and with that knowledge to decide whether to increase or sell the holding (J.A. 107 to 108). When ASARCO's prospects improved, Bendix made use of its entree to the ASARCO Board to propose that the two companies merge (J.A. 169, ¶61). It would be contrary to the common understanding of the word "passive" to apply it to a stockholder like Bendix who had two seats on the issuer's Board, who used its access to the Board to attempt to merge the two companies, and, when that failed, sold the stock and used the proceeds in an attempt to further one of its core businesses.

Bendix reaped additional advantages by taking a minority, rather than a control, position in ASARCO. From an operational standpoint, the relatively smaller position created less exposure to the cyclicality of ASARCO's earnings (J.A. 104; J.A. 128). Agee believed that a minority position had the further advantage of greater ease of exit (J.A. 135). Moreover, the relatively smaller financial commitment ensured that Bendix would

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[16] Agee defined the term "passive investment" as entailing an absence of "day-to-day or week-to-week management responsibility" with input by the investor into the issuer's affairs only at the level of the issuer's Board (J.A. 83). He distinguished this type of "passive investment" from an investment in a mutual fund. *Id.*

have sufficient financial resources to complete its other contemplated acquisitions for the forest products and industrial/energy groups (J.A. 104). Bendix in fact made these acquisitions. In 1979 it acquired Bass & Company and the Caradco Division of Scoville, both of which companies used forest products as raw materials (J.A. 191, ¶152; J.A. 184, ¶129). In 1980 Bendix spent $300.7 million to acquire Warner & Swasey Company, a machine tool manufacturer, which "enhanced Bendix' position in the machine tools business" (J.A. 191, ¶153; J.A. 183, ¶128).

C. Common Sense And Economic Reality Require That The ASARCO Gain Be Treated As Unitary Income.

Petitioner's argument in a nutshell is that the *only* way of establishing a unitary relationship between Bendix and the ASARCO stock interest is to find a unitary relationship between Bendix and ASARCO on an operational level. The argument conflicts with common sense and has no relation to economic reality.

1. Petitioner's Understanding of the Unitary Business Principle Cannot Be Squared With The Accepted Treatment of Working Capital Investments.

With the possible exception of petitioner,[17] it is generally conceded that interest income earned on the short-term

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[17] In its petition at 13, Allied appears to take issue with the concession of the American Home Products Corporation that income generated from the short-term investment of working capital is unitary income if the taxpayer uses the income and

(Continued on following page)

investment of working capital is unitary income. ASARCO conceded the point. *ASARCO*, 458 *U.S.* at 337, *n.*5 (O'Connor, J., dissenting).[18]

ASARCO's concession was based, not on a unitary relationship between debtor and creditor, but on the relation of the investment to the taxpayer's operations. The fact that the key to apportionability of income is its relationship to the taxpayer's business operations is borne out by the definition of business income under the Uniform Division of Income for Tax Purposes Act. 7A

(Continued from previous page)

underlying investments during the taxable year. *See American Home Products Corp. v. Limbach*, 49 *Ohio St.* 3d 158, 160-62, 551 N.E.2d 201, 204-05, *cert. denied sub nom. Limbach v. American Home Products Corp.*, 111 *S.Ct.* (1990).

[18] State courts that have addressed the issue generally agree. *See, e.g., NCR Corp. v. Comptroller of the Treasury*, 313 *Md.* 118, 544 *A.*2d 764, 772-75 (1988) (interest earned on short-term investments of surplus funds was unitary income, in part because the funds and the income, were routinely used for the company's general cash flow needs, expansion of the business, and retirement of debt); *M. Lowenstein Corp. v. S.C. Tax Comm'n*, 298 *S.C.* 93, 378 *S.E.*2d 272 (Ct. App. 1989) (interest on loans to affiliated corporation was unitary income because the lending and operating functions of the taxpayer were integrated and the interest income was used as working capital); *Lone Star Steel Co. v. Dolan*, 668 *P.*2d 916, 922 (Colo. 1983) (interest on loans to corporate affiliate was unitary; taxpayer was not engaged in a separate money lending business); *Cincinnati, New Orleans & Texas Pacific Ry. v. Ky. Dept. of Rev.*, 684 *S.W.*2d 303, 305 (Ky. Ct. App. 1985) (income from short-term investments was apportionable business income under state law); *Holiday Inns, Inc. v. Olsen*, 692 *S.W.*2d 850, 854 (Tenn. 1985) (same).

Uniform Laws Annotated 331 (West 1985) ("UDITPA").[19] Under UDITPA all income is either apportionable business income or nonbusiness income that is allocable to the commercial domicile. UDITPA, § 1(e). In *Container*, the Court recognized that the Uniform Act, as embodied in the California Revenue and Taxation Code, substantially tracks the unitary business principle and the rationale for formula apportionment. *Container*, 463 *U.S.* at 167. Apportionable business income is defined in UDITPA as:

> [I]ncome arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. [UDITPA, § 1(a)].

As made clear in the definition, "business income" is determined by reference to the "taxpayer's trade or business." There is no reference to the trade or business of anyone else.

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[19] As explained in *ASARCO*, UDITPA "is a tax allocation system approved in 1957 by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association. *ASARCO*, 458 *U.S.* at 310, n.3. At least 21 states have adopted all or portions of UDITPA, while several others have drawn on the Uniform Act's apportionment or other provisions. *Multistate Corp. Inc. Tax Guide*, ¶145 (CCH 1991). UDITPA was adopted as Article IV of the Multistate Tax Compact. *See United States Steel Corp. v. Multistate Tax Comm'n*, 434 *U.S.* 452, 457-58, n.6 (1978). *Id.* The Multistate Tax Commission is composed of the tax administrators of the 16 states that have joined the Multistate Tax Compact, an agreement concerning the state taxation of multistate businesses. *ASARCO*, 458 *U.S.* at 311-12; 1 *Multistate Corp. Inc. Tax Guide, supra*, ¶145.

No good reason appears for treating capital gain income differently from interest income when the income producing asset is integrated with the taxpayer's business operations or is held for a purpose relating to such business operations. The Court has stated as much, noting that "capital transactions can serve either an investment function or an operational function." *Container*, 463 *U.S.* at 180, n.19, (citing *Corn Products Refining Co. v. Commissioner*, 350 *U.S.* 46, 50-53 (1955), *reh'g denied* 350 *U.S.* 943 (1956)).[20] As one well known commentator has observed:

> There is, in point of fact, a variety of situations in which dividends and interest ought to be recognized as apportionable by the States under both the Due Process Clause and sound fiscal policy, in circumstances in which the payor corporations are not part of the recipient's unitary business conducted within the State. The income from temporary investments of working capital pending the need for the funds in the basic operations of the enterprise is one such category. [Hellerstein, *State Taxation I Corporate Income and Franchise Taxes* ¶9.12[3] at S298-99 (Cum. Supp. 1989)].

It cannot reasonably be maintained that only the immediate use of an investment in the day-to-day operations of a taxpayer can create a unitary relationship

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[20] In *Corn Products*, the Court held that a manufacturer of corn products that purchased corn futures to assure a future supply of its principal raw material was required to report the gain on sale of the futures contracts as ordinary income rather than capital gain. In *Arkansas Best Corp. v. Commissioner*, 485 *U.S.* 212 (1988), the Court limited the *Corn Products* doctrine to "hedging transactions that are an integral part of a business inventory purchase system [such that they] fall within the inventory exclusion of [I.R.C.] § 1221." *Id.* at 222.

between an investment and the operations of the taxpayer. *Cf. ASARCO*, 458 *U.S.* at 338 (O'Connor, J., dissenting). Where the business operations of the taxpayer include the acquisition and sale of interests in other corporations or where stock is acquired as part of a longer term business strategy, the "investment decision making" is integrated with the unitary business, and there is no sensible reason to deny unitary treatment. *Id.* at 335. Surely the duration of the investment cannot be the single determinative fact.

2. Petitioner's Theory of the Unitary Business Principle As Applied In This Case Is Inconsistent With Economic Reality.

At least since its decision in *Complete Auto Transit, Inc. v. Brady*, 430 *U.S.* 274 (1977), the Court has articulated an approach to state taxation that focuses on "economic realities," *id.* at 279, and the "practical effect" of a tax affecting interstate commerce. *Mobil*, 445 *U.S.* at 443; *Commonwealth Edison Co. v. Montana*, 453 *U.S.* 609, 616 (1981); *American Trucking Associations, Inc. v. Scheiner*, 483 *U.S.* 266, 294-96 (1987); *Trinova Corp. v. Michigan Dept. of Treasury*, 111 *S.Ct.* 818, 828 (1991) (principles governing state taxation of multistate businesses "seek to accommodate the necessary abstractions of tax theory to the realities of the marketplace." *Id.*).

The economic reality of Bendix' stock interest in ASARCO was that the investment was necessary to the accomplishment of Bendix' strategic goals as described in the company's annual reports, the testimony of its chairman, and the memoranda analyzing the potential acquisition. The economic reality was expressed by the

company's chairman to the effect that financial strategies, including minority stock investments, are as much a part of corporate management as the supervision of a corporation's traditional manufacturing operations (J.A. 133 to 137). Agee's view that businesses consist of "pools of assets" (J.A. 137) was echoed by the State's expert witness, who opined that one of the roles of top management is the continuous identification of investment opportunities in order to maximize stockholder return from a portfolio of investments, some involving operational control of the productive assets and others involving partial ownership (J.A. 141). It is not apparent why New Jersey should be prevented from imposing its CBT consistent with the economic reality of Bendix' situation.

Petitioner belittles New Jersey's argument as being founded on "corporate rhetoric" rather than "operational functions" (Pb35), but in Bendix' case, as distinct from the situation in *Woolworth*, the "rhetoric" materialized in actions that in fact created a unitary link between the ASARCO stock interest and Bendix' operations, *e.g.* the stepping stone nature of the stock purchase, Agee's active, central role in Bendix' acquisitions and every-day manufacturing operations, and the use of the stock proceeds in the attempt to expand Bendix' aerospace activities.

D. The Court's Holdings In *ASARCO* And *Woolworth* Do Not Preclude New Jersey From Taxing A Share Of The ASARCO Gain, But The Court's Broad Language In *ASARCO* Should Be Qualified.

Petitioner argues that in *ASARCO* and *Woolworth* the Court rejected New Jersey's application of the unitary

business principle. Petitioner claims that, at bottom, New Jersey's argument is no different than the business purpose argument advanced by Idaho in *ASARCO* and by New Mexico in *Woolworth*. Petitioner asserts that, since the purported unitary relationships in this case are even weaker than those in *ASARCO* and *Woolworth*, the holdings in those cases will have to be abandoned if the Court should affirm the New Jersey Supreme Court (Pb25 to Pb33). Finally, according to petitioner, the Court's decision in *Container* confirms the Court's rejection of the unitary business theory advanced by New Jersey. These assertions do not withstand analysis.

1. The Record Distinguishes this Case from *ASARCO* and *Woolworth*.

The Court has made clear that broad generalizations in its opinions are not controlling beyond the facts presented in those cases. *Gomillion v. Lightfoot*, 364 *U.S.* 339, 343-44 (1960); *Northern Nat'l. Bank v. Porter Township*, 110 *U.S.* 608, 615 (1884). Thus, the *holdings* in *ASARCO* and *Woolworth* cannot be broader than the facts before the Court, and the facts in those cases differ significantly from those presented here.

ASARCO and *Woolworth* involved the taxation of income (primarily dividends) received from wholly and partially owned subsidiaries received by nondomiciliary corporations. It was undisputed that each corporation did business in the taxing state, Idaho in the case of ASARCO and New Mexico in the case Woolworth. Both states had adopted a version of UDITPA and accordingly distinguished between business income which was apportioned among the states under the standard three-factor

formula and nonbusiness income which was allocated entirely to the commercial domicile. Both states had adopted combined reporting, but New Mexico did not permit it as to foreign affiliates such as Woolworth's that did not do business in New Mexico. Finding insufficient unitary links between the *operations* of the taxpayer and the *operations* of the dividend paying subsidiaries, the Court held in both cases that the nondomiciliary taxing state could not include in apportionable business income the dividends and other income received from the subsidiaries.[21]

The foundation for the Court's holdings in both *ASARCO* and *Woolworth* were the record facts in each case. In pointing out that the facts before it in *ASARCO* differed in critical respects from those in *Mobil*, the majority stated:

> As we have said elsewhere, the application of the unitary-business principle requires in each case a careful examination both of the way in which the corporate enterprise is structured and operates, and of the relationship with the taxing State. [*ASARCO*, 458 *U.S.* at 326, n.22].

In neither case did the record support the state's argument that the taxpayer's investments in its subsidiaries were integrated with its own business operations. As

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[21] Commentators have questioned the Court's application of the unitary business principle in *ASARCO*. Floyd, "The 'Unitary' Business in State Taxation: Confusion at the Supreme Court?" 1982 *B.Y.L. Rev.* 465 (1982); Hellerstein, "State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on *ASARCO* and *Woolworth*, 81 *Mich. L. Rev.* 157, 179 (1982); Note, "The Supreme Court, 1981 Term," 96 *Harv. L. Rev.* 62, 95 (1982).

reflected in the joint appendix in *ASARCO*, the stipulated facts relate exclusively to the functional integration on an operational level between the parent corporation and its subsidiaries.[22] The Multistate Tax Commission auditor noted additional facts suggesting a unitary relationship between the *operations* of ASARCO and certain of its subsidiaries.[23] Nor is there any evidence in the trial court proceeding as printed in the joint appendix in *ASARCO* that ASARCO's investments in the five subsidiaries were integrated *as investments* into ASARCO's operations.[24] In *Woolworth* there appears to have been virtually no factual record. *See Woolworth*, 458 *U.S.* at 359, n.7, 360.

Moreover, the Idaho trial court found as a fact that ASARCO's stock investments were " 'not integral to nor a necessary part of [ASARCO's] business operations. . . . ' " *ASARCO*, 458 *U.S.* at 324 n.21 (quoting the appendix to ASARCO's jurisdictional statement at 44a).

The Court was thus confronted with a record that did not support an argument by Idaho that the business use of an intangible should determine the apportionability of the intangible income, a trial court finding that

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[22] *See, e.g. ASARCO*, J.A. at 26a ¶4 (volume of sales); *ASARCO*, J.A. 29a, ¶5 (ownership percentage); *ASARCO*, J.A. 30a, ¶6 (interlocking directors and officers of ASARCO and its subsidiaries).

[23] *See, e.g. ASARCO*, J.A. 89a, ¶5 (flow of services); *ASARCO*, J.A. 94a, ¶3 (significant business activities between the taxpayer and the subsidiary). The single exception appears to be the auditor's contention that the gain on the sale of General Cable stock was apportionable because ASARCO acquired the stock to ensure itself a market (*ASARCO*, J.A. 95a).

[24] See *ASARCO*, J.A. 121a to 137a.

ASARCO's investments in the five subsidiaries were *not* integral to ASARCO's business operations, and, finally, a concession by Idaho "that a unitary business relationship between ASARCO and the subsidiaries is a necessary prerequisite to its taxation of the dividends at issue." *Id.* at 325.

Here, New Jersey does not concede that a unitary relationship between Bendix and ASARCO is necessary in order for New Jersey to tax an apportioned share of the capital gains realized by Bendix. The New Jersey Tax Court found that Bendix' investment in ASARCO was integral to Bendix' business operations. See Pet. App. C at 63a. There is no lapse here between the factual record and New Jersey's argument. The stipulated facts and the deposition of William Agee fully support New Jersey's position on the unitary business principle. If unitary business cases turn on their facts, *ASARCO* and *Woolworth* have little bearing here.

2. New Jersey's Argument Is Not One Of Amorphous Corporate Purpose.

The record facts dispose, as well, of petitioner's argument that New Jersey is making the same business purpose argument that the Court rejected in *ASARCO* and *Woolworth*. While Idaho may have argued that intangible assets should be considered unitary if used for purposes relating to a taxpayer's unitary business, *id.* at 326, there was nothing in the record to establish what that purpose might be nor how, in fact, the investments were " 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.' " *Id.* If the record facts revealed no "operational function" for an

investment, no "overall operational strategy" that included the investment, and no centralized management linking the investment to the taxpayer's operating business, under *Container* the investment would be passive. *See Container*, 463 *U.S.* at 180, n.19.

Here, the record establishes an "operational function" for the ASARCO investment and an "overall operational strategy" linking the ASARCO investment to Bendix' business. To take just one example, the ASARCO stock purchase served three operational functions (1) to further diversify the company, which was a longstanding operational strategy that is documented in the record, (2) to generate capital for one of Bendix' core businesses, the aerospace group, and (3) to gain knowledge of ASARCO's business and the nonferrous metals industry in order to determine whether to enlarge or sell Bendix' interest. These concrete, operationally oriented goals were in substance no different than Container's loans and loan guarantees to its subsidiaries that the Court characterized as "part of an effort to ensure that '[t]he overseas operations of [appellant] continue to grow and to become a more substantial part of the company's strength and profitability.' " *Id.*[25]

Moreover, Bendix' strategies materialized in fact. The record demonstrates that the ASARCO stock interest served to further diversify the company, generated cash for the aerospace sector, and provided the Bendix

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[25] Other operational functions for minority stock positions might include (1) the use of dividends and capital gains as working capital, *see Silent Hoist & Crane Co., Inc. v. Director, Div. of Taxation*, 100 *N.J.* 1, 494 *A.*2d 775, *cert. denied* 474 *U.S.*

(Continued on following page)

directors with sufficient knowledge to prompt an offer to merge the two companies.

3. The Court Should Make Clear That Intercorporate Relationships Are Not The Exclusive Indicia Of A Unitary Business, But It Need Not "Abandon" *ASARCO* Or *Woolworth*.

Despite the fact that *ASARCO* and *Woolworth* are distinguishable on their facts and that New Jersey's concept of a functionally integrated investment is more concrete than the business purpose test advanced in *ASARCO*, there is no getting around the fact that the Court stated in *ASARCO*:

(Continued from previous page)

995 (1985); (2) use of stock as collateral or as the convertibility feature in an issuance of convertible debt, *cf. International Paper Co. v. Director, Div. of Taxation*, 11 *N.J. Tax* 147, 170 (Tax Ct. 1990) (Hopkins, J. dissenting) *aff'd.* N.J. Super Ct., App. Div., No. A-5138-89T5 (May 13, 1991), *certif. denied* N.J. Sup. Ct., No. 33,784 (Oct. 18, 1991); (3) complete diversification as in the case of a conglomerate, *see W.R. Grace & Co. v. Commissioner of Revenue*, 378 Mass. 577, 393 *N.E.*2d 330 (1979). Additional examples can be found in the business income regulations of the Multistate Tax Commission, specifically Reg. IV.1(c)(4), and in the *amicus* brief of California filed in support of New Jersey in this case.

Petitioner's statement (Pb30) that Bendix's investments in corporations other than ASARCO were unitary because these "companies . . . fell squarely within Bendix's four core business groups . . . " is not consistent with the stipulated facts. Over the years Bendix at times invested in businesses in which it had no prior involvement (J.A. ¶130). *See* J.A. 188, ¶139; J.A. 173, ¶¶71, 73, 73a.

> We cannot accept, consistent with recognized due process standards, a definition of 'unitary business' that would permit nondomiciliary states to apportion and tax dividends '[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State. . . .' [*ASARCO*, 458 *U.S.* at 327 (quoting *Mobil*, 445 *U.S.* at 442)].[26]

Unless the statement is explained and qualified, this area of the law will remain confused.[27]

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[26] While the quoted statement refers to dividends, it was likely intended to apply to capital gains and interest income as well. *See ASARCO*, 458 *U.S.* at 330. However, an issuer whose stock is sold is not the "payor" of the capital gain realized on the sale. Bendix' capital gain on the ASARCO stock sale was not "paid" by ASARCO to Bendix, was never ASARCO's income, and was never taxed in ASARCO's federal or state returns.

[27] State courts have applied the *ASARCO/Woolworth* "payor-payee" rule as the exclusive test, eliminating capital gains and dividends from apportionable income despite evidence that the taxpayer's stock investment activities were an integral part of that taxpayer's unitary business activities. *Pledger v. Illinois Tool Works, Inc.*, 306 *Ark.* 134, 812 *S.W.*2d 101, 105, *cert. denied* 112 *S.Ct.* 418 (1991) (capital gains on sale of stocks non-unitary although investment activities were an integral part of taxpayer's regular business); *International Paper, supra*, 11 *N.J. Tax* at 165 (capital gain on sale of Bard stock nonunitary although stock was pledged to retire corporate debentures); *Corning Glass Works, Inc. v. Virginia Dept. of Taxation*, 241 *Va.* 353, 402 *S.E.*2d 35, 40, *cert. denied* 112 *S.Ct.* 277 (1991) (despite evidence that acquisition and divestiture of stock was a regular and integral part of taxpayer's business activities, capital gain on sale of stock ruled nonunitary).

The problem with the statement is that it is doctrinally unsound. Under the unitary business principle, a nondomiciliary corporation's simple presence in the taxing state is not sufficient to create a nexus to tax income earned at least in part outside the state; there must be "a 'minimal connection' between the interstate activities and the taxing State. . . . " *Mobil*, 445 *U.S.* at 436-37. It makes little sense to say that the activities in question are the activities of a corporation other than the taxpayer/recipient,[28] *e.g.* the activities of the payor of dividend income. As made clear by the Court's earlier unitary business cases, there is certainly no such requirement for apportioning income from ordinary business operations. *See* Pomp and Rudnick, "Federal Tax Concepts as a Guide for State Apportionment of Dividends: Life After *ASARCO*," 12 *Tax Notes* 411, 416 (Nov. 8, 1982). The source of the income, so far as the corporate taxpayer is concerned, is its holding of the investment, *see* "Note,"

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[28] The exception is a combined return where the "taxpayer" in effect is the unitary group consisting of two or more corporations. *See* Hellerstein, "State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on *ASARCO* and *Woolworth*," 81 *Mich. L. Rev.* 157, 182, n.155 (1982). New Jersey has consistently rejected combined reporting, insisting that its tax is on single corporate franchises measured by the income received by that franchise. *See Second Report of the Commission on State Tax Policy*, 97 (1947) (Da2); *Report of the New Jersey Tax Policy Committee, Vol. 5, Non-Property Taxes In a Fair and Equitable Tax System* 29 (1972) (Da5). As the income taxed under the CBT is the income of a single corporate franchise, the activities and income of separate corporations have no relevance to the taxpayer's return. *ASARCO* and *Woolworth*, by focusing exclusively on the payor-payee relationship, force New Jersey to apply a combined reporting concept to a statute that is flatly inconsistent with combined reporting concepts.

96 *Harv. L. Rev., supra*, at 92-93, and the question must be whether that stock holding is integrally related to the taxpayer's business. *Id.* at 95; *see ASARCO*, 458 *U.S.* at 335 (O'Connor, J., dissenting). In determining whether an investment is integrated with the taxpayer's business, control over the issuer and flows of product and services between the taxpayer and the issuer may be the decisive factors, *Mobil*, 445 *U.S.* at 442, but not because of the intercorporate relationships in themselves. Intercorporate relationships are significant for the inferences they create that the *investments* are functionally related to the taxpayer's business operations.

For instance, in the case of wholly-owned subsidiaries selling a substantial portion of their output to the parent-taxpayer, the unitary relationship between the corporations creates a strong presumption that the parent's investment in the subsidiary's stock is functionally integrated with the parent's business operations, *e.g.* to obtain a captive source of supply.[29] But control and functional integration between taxpayer and issuer cannot logically or as a matter of economic reality be the exclusive indicia of functional integration between the investment and the taxpayer's business. Floyd, "The Unitary Business . . . ," 1982 *B.Y.L. Rev., supra* at 482; *Container*, 463 *U.S.* at 179. Integration can be established just as well by an investment's role in the "management of the financial requirements" of the unitary business, *ASARCO*, 458 *U.S.* at 337 (O'Connor, J., dissenting), or its dependence on knowledge gained through the operating business, *id.* at 336, or by other links to the unitary business.

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[29] This was the case with ASARCO's six wholly-owned subsidiaries. *ASARCO*, 458 *U.S.* at 312-13.

The Court should thus clarify the quoted statement from *ASARCO* by holding that the ultimate inquiry is whether an investment is integrated with a taxpayer's business operations and that a unitary relationship between the taxpayer and the issuer of the stock is one, but only one, indicator of the necessary integration.

There is no need to go further and abandon the holdings in *ASARCO* and *Woolworth* for those decisions remain valid based on the facts and arguments there presented. The doctrine of stare decisis is therefore not implicated. *United States v. Ross*, 456 *U.S.* 798, 824 (1982) (stare decisis did not preclude a later decision rejecting the reasoning of an earlier case where the holding of the earlier case was adhered to and legitimate reliance interests were not upset).[30]

4. *Container* Supports New Jersey's Position.

Finally, *Container* supports New Jersey's, not petitioner's, argument. Although the unitary relationships were those *between* Container and its subsidiaries, as indicated above, intercompany relationships must be significant factors in determining which corporations to include in a combined report. The import of *Container* is its recognition that the existence of a unitary business can be shown in any number of ways, *Container*, 463 *U.S.* at 164,

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[30] If stare decisis were implicated, the doctrine has less force in a case involving the Constitution where "correction through legislative action is practically impossible. . . ." *Edelman v. Jordan*, 415 *U.S.* 651, 671, n.14, *reh'g denied* 416 *U.S.* 1000 (1974), (quoting *Burnet v. Coronado Oil & Gas Co.*, 285 *U.S.* 393, 406-08 (1932) (Brandeis, J., dissenting)); *Payne v. Tennessee*, 111 *S.Ct.* 2597, 2609-10 (1991).

179; that all that need be shown by the taxing state is "something beyond the mere flow of funds arising out of a passive investment which renders formula apportionment a reasonable method of taxation, *id.* at 166; its recognition that the ultimate question in the case of investment income is whether the investment "serve[s] either an investment function or an operational function," *id.* at 180, n.19, and its repeated emphasis that the burden in these cases is on the taxpayer to show "by clear and cogent evidence" that the state is taxing extraterritorial income.[31] *Id.* at 164, 175.

Under these standards, Bendix' stock interest in ASARCO was part of Bendix' unitary business. *Container* opens the door to demonstrating the existence of a unitary business through an operational strategy linking business operations and acquisitions. The ASARCO stock interest did more than simply generate a flow of funds; it served an operational function by continuing the historical diversification of the company, by providing Bendix' management with information on the nonferrous metals industry and ASARCO, and by serving as a stepping stone to an acquisition in the area of one of Bendix' core businesses. Petitioner has failed to prove by "clear and cogent evidence" that New Jersey is taxing extraterritorial income.

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[31] A requirement of proof "by clear and cogent evidence" has been likened to establishing that the truth of the asserted matter is "highly probable." *McCormick on Evidence* § 340 (3rd ed. 1984).

E. Petitioner's Proposed Tax Exemption Would Be Unfair To The States And Unnecessary To Protect Interstate Business.

Petitioner's concept of a fair tax on its investment income appears to be virtually no tax at all. Petitioner presumably concedes that Michigan, Bendix' state of commercial domicile, can tax the ASARCO gain. Michigan, however, includes capital gains in the apportionable tax base under the Michigan single business tax. *Mich. Comp. Laws*, §§ 208.3(3) and 208.9 (West 1991).[32] If, as petitioner claims, the ASARCO gain can be taxed by New Jersey only upon proof that ASARCO and Bendix were operating a unitary business, presumably petitioner would take the position that no other nondomiciliary state can tax the income either. It is not unfair or "overzealous" to require that interstate businesses based in a state that apportions investment income apportion that income in other states as well. It is not unfair or "overzealous" for New Jersey to impose a tax amounting to .72% of the ASARCO gain. While double taxation of investment income is a theoretical possibility due to the fact that some states allocate investment income entirely to the commercial domicile while others tax it on an apportioned basis, such double taxation has not been shown here, and, until it is shown, the Court should not assume that it is a significant problem. *See Moorman*, 437 *U.S.* at 279-80; *Mobil*, 445 *U.S.* at 444-46.

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[32] The business income portion of the Michigan single business tax is based on federal taxable income. *Mich. Comp. Laws* § 208.3(3) (West 1991). A corporation's federal taxable income includes capital gains. *I.R.C.* § 11(a), § 63(a), § 61(a) (1991).

In sum, Bendix has failed to show by "clear and cogent evidence" that a share of the ASARCO gain is beyond New Jersey's taxing power. The Court should thus adhere to its longstanding rule of not upsetting state taxing schemes and deferring to the judgment of state courts. *Container*, 463 *U.S.* at 175-76.

CONCLUSION

For the foregoing reasons the judgment of the Supreme Court of New Jersey should be affirmed.

Respectfully submitted,

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February 1992

New Jersey Administrative Code
Title 18, § 7-11.15 (1991)

18:7-11.15 Consolidated returns

(a) Corporations are not permitted to file consolidated returns. Provided, however, any business conducted by an individual, partnership, or corporation or any other entity, or any combination thereof holding a license pursuant to the Casino Control Act shall file a consolidated corporation business tax return as described at N.J.A.C. 18:7-1.17

(b) Except as provided in (a) above, where a taxpayer has filed a consolidated return with the Internal Revenue Service for Federal income tax purposes, it must complete its return under the act and must reflect its entire net income and entire net worth as if it had filed its Federal return on its own separate basis.

STATE OF NEW JERSEY

SECOND REPORT

OF

The Commission on State Tax Policy

Part I: Taxation of Tangible Personal Property

Part II: Corporation Business Tax Act (1945)

Submitted to the Governor and to the Legislature, March 24, 1947

* * *

[p. 96]

3. *Consolidated Returns*

The Corporation Business Tax Act (1945) provides that:

> "Every domestic or foreign corporation which is not hereinafter exempted shall pay an annual franchise tax . . . for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office in this State. And such franchise tax shall be in lieu of all other State, county or local taxation upon or measured by intangible personal property used in business by corporations liable to taxation under this act." (Laws 1945, ch. 162, sec. 2.)

Thus, under the act, all corporations chartered in New Jersey and all foreign corporations qualified to do business in New Jersey are taxable. The tax is assessed for the corporate privilege and in lieu of taxation as property

of corporate owned intangibles. Corporations which operate as a single enterprise under a single charter are taxed for a single privilege according to their size as measured by net worth. Corporations which choose to operate through subsidiaries exercise more than a single privilege and they are taxed accordingly. In rare instances multiple corporate units

[p. 97]

pay less tax than they would as a single unit. In general, however, the tax upon multiple corporate units exceeds the tax which would be assessed upon the group as a single unit.

Use of consolidated returns under the Corporation Business Tax Act would have the effect of grouping two or more corporations and assessing a franchise tax upon their combined net worth after elimination of inter-corporate accounts. The resulting tax would depend upon group holdings and group activity and would not reflect a payment for individual corporate charters or privileges. For large families of corporations such as those controlled by some of New Jersey's holding companies, it would virtually eliminate the tax for corporate privileges exercised by any but the parent corporation. Because consolidation would combine allocation factors as well as balance sheet accounts, it would enable corporate families operating on a national or international basis to escape all but a nominal tax in New Jersey.

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[p. 100]

While these data as tabulated from the 1946 corporation business tax returns are not adequate to determine the exact effect of consolidated returns, they do indicate the implications of such a revision. *First,* consolidated returns would result in a greatly reduced tax base and tax. It would virtually eliminate the tax liability of holding corporations and a large part of the reduction in tax base would occur among large corporations which account for a major portion of the tax. *Second,* consolidated returns would grant reduced group tax rates for charters to families of corporations and thus depart from the payment for each corporate privilege or charter. Against this background the *Commission* recommends:

> THAT PROVISIONS OF THE CORPORATION BUSINESS TAX ACT (1945) WHICH DO NOT PERMIT THE FILING OF CONSOLIDATED RETURNS REMAIN UNCHANGED.

* * *

Part V

of the Report of the

NEW JERSEY TAX POLICY COMMITTEE

Non-Property Taxes in a Fair
and Equitable Tax System

Submitted to Governor William T. Cahill
pursuant to Executive Order No. 5 of 1970

TRENTON, NEW JERSEY

February 23, 1972

* * *

Consolidated Returns

[p. 28]

Formulary apportionment is a technique developed by the States for determining the portion of the measure of a tax attributable to the State, where the taxpayer's activities, assets and business are located in more than one State, or are in part outside the country. One of the most troublesome and controversial issues in State corporation taxation has been how to determine the State's share of the net income, or capital stock, or other tax measure of an enterprise conducted through affiliated corporations operating in various States and in foreign countries. This issue has taken on increasing importance as business has expanded and corporate pyramids have multiplied, and is now exacerbated by the growth of the corporate conglomerate.

The States sought to deal with affiliated groups of controlled corporations which siphoned off some income or other taxable base, through artificially fixed prices for

goods or services and other intercompany arrangements, by enacting provisions for re-allocating income and deductions on an arm's length basis. This is the instrumentality employed by Section 482 of the Federal Internal Revenue Code for dealing with intercompany dealing among affiliated and related United States and foreign corporations. As experience developed and as businesses expanded, this type of tool proved inadequate to the task of determining the income attributable to a State in which a corporation was conducting an operating function of an integrated enterprise organized in a multicorporate structure. This was not merely because of the difficulties involved in determining reasonable arm's length prices, but for the more fundamental reason that separate accounting was increasingly regarded by State tax administrators, by its nature, as an unsatisfactory technique for determining the share of the income of a unitary business that ought to be attributed to the various States in which the business is conducted.[25] As a consequence, apportionment by formula began to be extended to multicorporate, unitary businesses, with the consolidated or combined return employed as the method of achieving this result.[26]

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[25] For the history of the development of formulary apportionment as applied to a single corporation doing business in more than one State, and its subsequent extension by some States to an affiliated or controlled group of corporations, see Hellerstein, State and Local Taxation: Cases and Materials, Ch. 8 (3rd ed. 1969).

[26] The Report of the Special Subcommittee on State Taxation of Interstate Commerce, Note 13, supra, enumerates 23 States "that have provisions authorizing their administrators to require or permit consolidated returns in order clearly to reflect income", citing:

(Continued on following page)

The unitary business doctrine has been recognized by the courts of this State under the Corporation Business Tax, as applied to a single corporation doing a multistate business.[27] However, in the absence of any explicit provision in the statute for consolidated reporting, the courts have upheld the Director's regulation that consolidated

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(Continued from previous page)

Ariz. Rev. Stat., Sec. 43135(e); Cal. Rev. and Tax Code Secs. 25104, 25105; Colo. Rev. Stat., Sec. 138-1-28; Conn. Gen. Stat., Secs. 12-221, 223; Del. Code tit. 30, Sec. 1906; Ga. Code, Sec. 92-3202; Reg. Sec. 92-3209; Iowa Reg. 22.37; Kans, Reg. 92-4-98; Ky. Rev. Stat., Secs. 141.205(1), (3); La. Rev. Stat., Sec. 47:95; Md. Code art. 81, Sec. 296; Minn. Stat., Sec. 290.34(2); Mont. Reg. 208; N.Y. Tax Law, Sec. 211.4; N.C. Gen. Stat., Sec. 105-143; N. Dak. Cent. Code, Sec. 57-38-14; Okla. Stat. tit. 68, Secs. 878(i), (j); Oreg. Rev. Stat., Sec. 317.360; S.C. Code, Secs. 65-285, 297; Utah Reg. 4; Vt. Reg. Arts. 600, 607; Va. Code, Secs. 58-136, 138, 139; Wis. Rev. Stat., Sec. 71.11(7)(b). (Vol. I, p. 246, note 217).

It then declares that, "of these, at least five States have provisions which appear broad enough to require or permit a combined report", Arizona, California, Georgia, Minnesota and New York, as to which it appears consolidation may be permitted or required without a showing of artificial pricing or other income distorting arrangements. Under the Wisconsin corporate tax, the Department of Taxation may require the filing of consolidated returns. Wisc. Stats., Sec. 71.11-7(b).

[27] Household Finance Corp. v. Director, Division of Taxation, 36 *N.J.* 353, 177 *A.*2d 738 (1962); F.W. Woolworth Co. v. Director, Division of Taxation, 45 *N.J.* 460, 213 *A.*2d 1 (1965).

returns for a unitary enterprise, operating through affiliated corporations, are not permitted.[28]

If a consolidated return provision were to be acted, [sic] we would recommend that taxpayers be given the right to file consolidated returns, and that the Director of the Division of Taxation likewise have the power to require the filing of a consolidated return, provided, of course, the statutory standards prescribed for consolidation are met. We know of no justification for the use of a one-way street, i.e., as is true in some States, where the taxpayer has the privilege of filing a consolidated return, but such reporting may not be required by the taxing authority,[29] or vice versa.[30]

[p. 29]

In the *Second Report* of the Commission on State Tax Policy made in 1947, consolidated returns were considered and rejected, on the ground that the effect would be only to reduce the taxes of New Jersey holding companies and their subsidiaries (pp. 96, et seq.). The 1947 Corporation Business Tax, however, was a very different levy from the present tax; that statute imposed only a net worth tax. A 50% deduction was allowed for investments in subsidiaries only to the extent of the subsidiary's New Jersey allocation percentage, whereas under the present

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[28] United States Steel Corp. v. Director, Division of Taxation, 38 *N.J.* 533, 186 *A.*2d 266 (1962).

[29] See Mass. Gen. Laws, ch. 63, Sec. 39.

[30] See the Wisconsin provision, Note 31, supra.

statute, there are two types of deductions allowed for subsidiary capital: (a) 50% of the holding company's book investment in the subsidiary, regardless of whether the latter is taxable in New Jersey, plus (b) the continuation of the 1947 deduction of 50% of the subsidiary's New Jersey allocation percentage, applied to the book value of the investment. (Secs. 4(d) and 9).

In 1947, no income tax was imposed under the Corporation Business Tax. Under the present corporation net income tax, dividends from subsidiaries are already eliminated, so that their elimination as intercompany items in a consolidated return would have no tax effect (Sec. 4(k)). At the present time, the income of a holding company operating in New Jersey is taxed, as is the income of its subsidiaries, to the extent they do business in the State. The income of the other affiliates in the unitary business is not taken into account. But, under consolidating income reporting, the net income of the entire unitary enterprise, including companies not doing business in the State, would be taken into account under the apportionment formula in determining the portion of the income of the unitary business that should be attributed to New Jersey.

Consequently, the conclusion reached in the 1947 report that consolidated returns would result in a reduction of revenues may not be true today. No data are available from which a reasonably workable estimate can be made as to whether, to what extent, and in which industries, revenues would increase or decrease, as a result of the enactment of a consolidated return provision. Moreover, there are troublesome problems, and

sharply conflicting approaches by State tax administrators and representatives of business as to how to define the elusive concept of a unitary business, the scope of an affiliated group to be included in a consolidated return, whether subsidiaries operating in foreign countries should be included, the treatment of intercompany dividends, and the like.[31] Legislation has been pending in Congress since 1964 for the adoption of a Federal statute, which would require the States to follow uniform Congressionally established standards and rules for consolidated returns.[32] The States have generally opposed this legislation, and efforts to reconcile the views of the various States and the larger businesses have been made, and are continuing, in the hope that acceptable solutions may be found which could be embodied in Federal or State legislation. While these efforts have thus far not achieved the wide concensus required to produce a viable solution acceptable to the interested parties, they are continuing.

Accordingly, in view of the importance of substantial uniformity of the laws and regulations of at least the major States in dealing with the unitary business and

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[31] For an analysis of the conflicting approaches to the unitary business doctrine and consolidated returns, see Hellerstein, "Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business", 21 National Tax Journal (1968); and Rudolph, "State Taxation of Interstate business: The Unitary Business Concept and Affiliated Corporate Groups", 25 Tax Law Review 171 (1970).

[32] These provisions are included in bills pending before Congress referred to in Note 13, supra.

consolidated return issues, it is our conclusion that this State ought to await further action by the States or by Congress, hopefully growing out of the joint efforts of State tax administrators and representatives of business, to find mutually acceptable solutions, before modifying the present law in this area.

The Committee recommends:

The existing provisions of the Corporation Business Tax, which have been administered and interpreted as debarring the application of the unitary business doctrine to an enterprise consisting of separate, affiliated corporations and as precluding the filing of consolidated returns, should remain unchanged, pending further developments in this area designed to achieve a uniform treatment of these matters by the various States.

* * *

Supreme Court, U.S.
FILED
FEB 26 1992
OFFICE OF THE CLERK

No. 91-615

In the Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation, PETITIONER

v.

DIRECTOR, DIVISION OF TAXATION, RESPONDENT

On Writ of Certiorari to the Supreme Court of New Jersey

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTRODUCTION	1
ARGUMENT	2
I. THERE IS NEITHER FACTUAL NOR LEGAL FOUNDATION FOR NEW JERSEY'S ASSERTION THAT BENDIX'S INVESTMENT IN ASARCO SERVED AN "OPERATIONAL" RATHER THAN AN "INVESTMENT" FUNCTION	2
A. New Jersey Errs In Asserting That Bendix's Investment In ASARCO, Because It Diversified Bendix's Operations And Contributed To Bendix's Profitability, Served An Operational Function	2
B. There Is No Record Support For The Assertion That Bendix Had An Operational Function Of Acquiring And Selling Interests In Other Corporations	7
II. THIS CASE CANNOT BE MEANINGFULLY DISTINGUISHED FROM *ASARCO* AND *WOOLWORTH*, WHICH REFLECT SOUND AND SETTLED PRINCIPLES OF CONSTITUTIONAL ADJUDICATION THAT SHOULD NOT BE DISTURBED	9
III. THE RULE OF LAW IMPLICIT IN THE DECISION BELOW IS UTTERLY UNWORKABLE, EFFECTIVELY JETTISONS ALL CONSTITUTIONAL RESTRAINTS ON STATE TAXATION OF INCOME FROM INTANGIBLES, AND SUBJECTS MULTISTATE BUSINESSES TO INCREASED RISK OF MULTIPLE TAXATION	13
IV. ANY DRASTIC CHANGE IN THE LAW SHOULD BE MADE PROSPECTIVE ONLY	17
CONCLUSION	18

TABLE OF AUTHORITIES

Cases: Page

ASARCO, Inc. v. *Idaho State Tax Comm'n*, 458 U.S. 307 (1982) ..... *passim*
Chevron Oil Co. v. *Huson*, 404 U.S. 97 (1971) 18
Cipriano v. *City of Houma*, 395 U.S. 701 (1969) 18
Container Corp. of America v. *Franchise Tax Bd.*, 463 U.S. 159 (1983) 1, 2, 3, 8-9, 15
Corn Products Refining Co. v. *Commissioner*, 350 U.S. 46 (1955) 15
Exxon Corp. v. *Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980) 3, 6
F.W. Woolworth Co. v. *Taxation and Revenue Dep't*, 458 U.S. 354 (1982) ..... *passim*
Kamen v. *Kemper Financial Services, Inc.*, 111 S. Ct. 1711 (1991) 10
Miller Bros. v. *Maryland*, 347 U.S. 340 (1954) 4, 6
Mobil Oil Corp. v. *Commissioner of Taxes*, 445 U.S. 425 (1980) 3, 10
Monsanto Co. v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984) 10
Moorman Manufacturing Co. v. *Bair*, 437 U.S. 267 (1978) 15, 16
Northwestern States Portland Cement Co. v. *Minnesota*, 358 U.S. 450 (1959) 16
Silent Hoist & Crane Co. v. *Director, Division of Taxation*, 494 A.2d 775 (N.J.), cert. denied, 474 U.S. 995 (1985) 11
Trinova Corp. v. *Michigan Dep't of Treasury*, 111 S. Ct. 818 (1991) 16
United Parcel Service, Inc. v. *Mitchell*, 451 U.S. 56 (1981) 10
Wallace v. *Hines*, 253 U.S. 66 (1920) 10
Wisconsin v. *J.C. Penney Co.*, 311 U.S. 435 (1940) 11

Statutes and Regulations:

N.J. Stat. Ann. § 54:10A-4 7
Uniform Division of Income for Tax Purposes Act §§ 1(a), 1(e), 6(c), 7 15

TABLE OF AUTHORITIES—Continued

Miscellaneous: Page

Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387 (1983) 17

Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993 (1986) 17

J. Hellerstein & W. Hellerstein, *1989 Cumulative Supplement* to J. Hellerstein, *State Taxation* (1983) 11

1 Multistate Corporate Income Tax Guide (CCH) (1991) 15

REPLY BRIEF OF PETITIONER

INTRODUCTION

The central question in this case is whether there was a sufficient connection between Bendix's business activities in New Jersey and its investment in ASARCO to permit New Jersey to tax Bendix's gain from the sale of its ASARCO stock. Our opening brief argued that the requisite link was missing because, under established constitutional standards tracing back to the 19th century and recently applied by this Court in *ASARCO* and *Woolworth*, Bendix's passive investment in ASARCO could not be considered part of the unitary business that Bendix conducted in New Jersey.

New Jersey's response proceeds along two analytical paths. First, it characterizes Bendix's investment in ASARCO as part of Bendix's business activity in New Jersey on the theory that the investment served an "operational function" in Bendix's unitary business. N.J. Br. 26. Second, New Jersey seeks to undermine *ASARCO* and *Woolworth* and to distinguish them into oblivion. As we demonstrate below, New Jersey's characterization of Bendix's investment in ASARCO as "operational" cannot be squared with the undisputed facts of this case or with the line this Court has drawn between an "investment function" and an "operational function." *Container*, 463 U.S. at 180 n.19. Moreover, New Jersey's effort to distinguish *ASARCO* and *Woolworth* from the instant case is futile. Finally, the essentially contentless "rule" of law reflected in the decision below, and in the efforts of New Jersey and its amici to defend it, would eviscerate settled constitutional restraints on state taxation and create an utterly unworkable standard for adjudicating future controversies.

ARGUMENT

I. THERE IS NEITHER FACTUAL NOR LEGAL FOUNDATION FOR NEW JERSEY'S ASSERTION THAT BENDIX'S INVESTMENT IN ASARCO SERVED AN "OPERATIONAL" RATHER THAN AN "INVESTMENT" FUNCTION.

It is beyond dispute that Bendix and ASARCO were not engaged in a unitary business, a point New Jersey now explicitly concedes. N.J. Br. i. Consequently, Bendix's gain from the sale of its ASARCO stock is taxable by New Jersey only if the investment itself constituted part of Bendix's unitary business as carried on in part in New Jersey. But New Jersey does not contend—nor, in light of the record, could it contend—that Bendix employed the ASARCO stock in Bendix's day-to-day operations as working capital or as an asset serving an operational function under the *Corn Products* doctrine. Instead, New Jersey asserts that Bendix's investment in ASARCO served an operational function as part of Bendix's "strategy" to "diversify Bendix's overall operations" (N.J. Br. 25) and to "grow and become more profitable" (N.J. Br. 28). New Jersey also suggests, although almost as an afterthought, that Bendix's investment in ASARCO served an operational function because Bendix's "business operations . . . include the acquisition and sale of interests in other corporations." N.J. Br. 36. New Jersey's first argument fails as a matter of law to establish that Bendix's investment served an operational function, and the second is without support in the record.

A. New Jersey Errs In Asserting That Bendix's Investment In ASARCO, Because It Diversified Bendix's Operations And Contributed To Bendix's Profitability, Served An Operational Function.

Because Bendix's investment in ASARCO cannot be considered "operational" as that term has been employed by this Court, *Container*, 463 U.S. at 180 n.19, New Jersey is compelled to redefine the concept of an operational function in an effort to fashion a constitutional

predicate for taxing Bendix's gain from the sale of its ASARCO stock. New Jersey contends that the ASARCO investment served an operational function, and therefore was part of Bendix's unitary business, because the ASARCO investment diversified Bendix's range of activities, thereby "insulating the company's overall profitability from the cyclical downturns in its core operating areas and fostering the future growth of the company." N.J. Br. 25.

While New Jersey couches its argument in terms of the familiar unitary factors of "functional integration" and "centraliz[ed] . . . management," *Mobil*, 445 U.S. at 438; *Exxon*, 447 U.S. at 222, New Jersey's construct bears no resemblance to the unitary business concept delineated by this Court. That concept requires that the "out-of-state activities of the purported unitary business"—such as Bendix's activities in managing its investment in ASARCO—must "be related in some concrete way to the in-state activities"—such as Bendix's aerospace operations in New Jersey—"beyond the mere flow of funds arising out of a passive investment or a distinct business operation." *Container*, 463 U.S. at 166.

For purposes of this argument we accept New Jersey's contention (*e.g.*, N.J. Br. 32-33, 43-47) that intangible income can in some circumstances be part of a taxpayer's unitary business operations even though the business of the taxpayer and that of the company in which it has invested are not unitary. For example, interest paid by a bank on certificates of deposit in which a taxpayer has temporarily invested working capital would be apportionable income of the enterprise in which the taxpayer employs the working capital, even though the bank's business and the taxpayer's business are not unitary. But here New Jersey points to no such concrete link. Rather, it alleges "functional integration" between Bendix and its ASARCO investment because the investment served to: "diversify Bendix' overall operations" (N.J. Br. 25); "ensur[e] overall profitability" (*id.*); and "generate . . . capital" for future acquisitions (N.J. Br. 26). Nowhere

does New Jersey indicate *how* Bendix's investment in ASARCO affected Bendix's existing unitary operations in New Jersey. If ASARCO stock had gone down in value, thereby rendering Bendix's investment in ASARCO unprofitable, there is nothing in the record to suggest that this would have had any impact—much less a "concrete" impact—on Bendix's New Jersey operations, aside from the constitutionally irrelevant fact that Bendix would no longer derive as much "economic benefit . . . from its ownership of stock in another corporation." *Woolworth*, 458 U.S. at 364.

Indeed, New Jersey's position that "Bendix' use of the ASARCO sale proceeds in its attempt to acquire Martin Marietta . . . served an 'operational function'—the growth and profitability of one of Bendix' core businesses" (N.J. Br. 26) reveals just how far New Jersey would loosen the unitary business concept from its constitutional moorings. No longer would the "definite link" (*Miller Bros. v. Maryland*, 347 U.S. 340, 345 (1954)) between a nondomiciliary taxpayer's out-of-state investment and its in-state business activities be measured by a "concrete" connection between the two. Instead, a unitary link would be traced by drawing a line from the *subsequent* use of the proceeds back to the investment, even though the actual link between the investment and the taxpayer's business had been completely severed. This "stepping stone" (N.J. Br. 48) theory of a unitary business would stretch the concept beyond constitutional recognition, allowing states to apportion income from investments with which they have no meaningful connection merely because the proceeds from such investments were subsequently used to support the taxpayer's business operations in the state.

New Jersey's reliance on Bendix's alleged "strong centralized management" (N.J. Br. 28) as providing an operational link between Bendix's investment in ASARCO and its unitary New Jersey business activities is similarly misguided. First, there is nothing in any of the decisions below, or in the record, that would support the

claim that Bendix's management created a "flow of value" between Bendix's investment in ASARCO and its unitary operations conducted in part in New Jersey. In particular, since Bendix did not control ASARCO, it lacked the power to mobilize the income and assets of ASARCO to benefit Bendix's regular businesses. Unlike the normal countercyclical investment that could provide for a flow of funds when the primary line of business experiences a downturn, Bendix could obtain a flow of funds from ASARCO only if the independent ASARCO board of directors elected to declare a dividend.

Second, the "centralized management" of the ASARCO investment that allegedly linked that investment to Bendix's ongoing unitary operations (N.J. Br. 29-30) consisted simply of those minimal actions of a prudent investor necessary to acquire, oversee, and dispose of a passive investment. Those activities had nothing to do with the ordinary operation of Bendix's businesses in New Jersey. Thus, Bendix consulted outside experts and publicly available sources of information in evaluating the wisdom of the investment, Stip. ¶¶ 62, 64 (J.A. 165); Exh. D (J.A. 231-33); Exh. E (J.A. 95-100); Stip. ¶ 45 (J.A. 166-67); Exh. F (J.A. 127); it periodically reviewed the status of its investment, Stip. ¶¶ 57, 59-60 (J.A. 168-69); and, when the price of the investment rose and Bendix decided to reduce its investment in natural resource businesses, Bendix sold the investment. Stip. ¶ 58 (J.A. 169); Stip. ¶ 64 (J.A. 171). There is no suggestion that, in investing in ASARCO, Bendix ever relied on "the resources of information and expertise developed in its own . . . business," *ASARCO*, 458 U.S. at 337 (O'Connor, J., dissenting), or that the "inside" information that Bendix derived from having two of its directors sit on ASARCO's board of directors ever was or realistically could have been employed to further Bendix's unitary business operations conducted in part in New Jersey.

New Jersey's strained attempt to draw an analogy between this case and *Exxon* (N.J. Br. 28-30) reveals its fundamental misconception of the unitary business doc-

trine. In *Exxon*, this Court observed that a vertically integrated oil company—the quintessential unitary business—was a "highly integrated business which benefits from an umbrella of centralized management and controlled interaction." 447 U.S. at 224. Exxon's management took actions to coordinate the oil company's core business operations, including centralized purchasing, gasoline supply, and uniform packaging. *Id.* Because there was clearly a "flow of value" from Exxon's out-of-state production and refining operations to its in-state marketing operations, Wisconsin was entitled to include the income from all such operations in Exxon's apportionable tax base.

New Jersey argues that Bendix's income from its ASARCO investment, like Exxon's income from its integrated oil business, should be part of the taxpayer's apportionable tax base. But this argument completely loses sight of the underlying function of the unitary business principle, which is to confine the state's power to tax income from out-of-state activities to circumstances in which there is a "flow of value" between the in-state and out-of-state activities. The mere fact that Bendix's management in Southfield, Michigan oversaw the company's minority investment in ASARCO and analyzed it "from the point of view of Bendix' existing businesses and its effect on Bendix' future growth" (N.J. Br. 29) does not respond to the critical question whether the investment was related "in some concrete way" to Bendix's operations *in New Jersey*. What counts is whether the investment was actually employed to support *those* operations—whether as working capital, or as a hedge against price increases (as in *Corn Products*), or to secure a source of supply (as arguably was the case in *ASARCO*). Because the ASARCO investment was not so employed, it lacked the requisite "minimum connection" (*Miller Bros.*, 347 U.S. at 345) with Bendix's

unitary New Jersey business operations to enable New Jersey to tax the ASARCO gain.[1]

B. There Is No Record Support For The Assertion That Bendix Had An Operational Function Of Acquiring And Selling Interests In Other Corporations.

New Jersey and its amici never explicitly take issue with the fact that virtually all of the companies that Bendix acquired during the 1960s and 1970s were directly related to its preexisting lines of business. Allied-Signal Br. 5, 30. Nonetheless, in an effort to paint Bendix's profit from its ASARCO investment as arising out of the regular business operations that Bendix conducted in part in New Jersey, they utilize these acquisitions to ascribe to Bendix a business function of buying and selling interests in other corporations. N.J. Br. 36; Cal. Am.

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[1] The suggestions by New Jersey and its amici that Bendix was inconsistent in its treatment of the ASARCO investment in its tax returns (N.J. Br. 13-14; Cal. Am. Br. 23-25) lack substance. First, Bendix deducted the expenses associated with its acquisition of the ASARCO stock from its New Jersey apportionable tax base because that is what the statute required. N.J. Stat. Ann. § 54:10A-4 (Pet. App. 69a-71a). New Jersey law does not provide for the add back of expenses related to income not taxable by New Jersey. Second, Bendix's inclusion of its ASARCO dividends in its New Jersey returns appears to have been an oversight. As soon as this oversight was discovered, Bendix sought to exclude the ASARCO dividends from its New Jersey tax base for the same reasons that it sought to exclude the capital gain on its ASARCO stock from its tax base. See Complaint ¶ 3(G) (J.A. 11). However, Bendix subsequently discovered that its claim with respect to the dividends was barred by the statute of limitations; it thereupon amended its complaint in the New Jersey Tax Court to drop the claim. Third, Bendix's failure to exclude its investment in ASARCO from the net worth portion of New Jersey's corporation business tax was attributable to the fact that the amounts of tax involved were relatively small and Bendix never focused on the question. It clearly did not amount to a "concession" (N.J. Br. 14) that the ASARCO stock was apportionable for New Jersey tax purposes, and none of the three New Jersey courts through which this case has journeyed even suggested that any such concession might have been made.

Br. 20-21. The record belies this claim, which was not relied upon by any of the courts below in reaching their decisions.

First, it is beyond dispute that the overwhelmingly majority of Bendix's acquisitions were designed to strengthen or expand Bendix's existing operations and to enhance its product lines. Allied-Signal Br. 5, 30 & n.13; Stip. ¶¶ 128-153 (J.A. 183-92). There is nothing in the record to support the allegation that Bendix was also in the business of buying and selling interests in other corporations. Indeed, the stipulated facts are to the contrary. Stip. ¶ 11 (J.A. 154-55). Bendix's infrequent acquisitions (and subsequent dispositions) of interests in unrelated businesses hardly make investments in other corporations Bendix's stock in trade.

Second, in any event, Bendix's investment in ASARCO was so different from Bendix's investments in other corporations as to preclude characterization of the ASARCO investment as operational. Unlike virtually every other instance, which involved acquisition of a controlling interest in another company, Bendix's investment in ASARCO was a minority interest that gave it no control of ASARCO. Similarly, Bendix's investment in ASARCO was (in William Agee's words) "different" because "[i]t was a nonoperating situation." J.A. 28-30. This meant, among other things, that Bendix could not control the direction taken by ASARCO's business or the flow of dividends in order to harmonize them with Bendix's own operational needs.

Third, even if Bendix were viewed as having had an investment business that included the acquisition, oversight, and management of stock in ASARCO, nothing in the record would support the conclusion that any such investment business was unitary with the businesses that Bendix was conducting in part in New Jersey or that the investment business itself was carried on in New Jersey.

In short, under any theory heretofore recognized by this Court, Bendix's investment in ASARCO cannot be characterized as serving an "operational function." *Con-*

tainer, 463 U.S. at 180 n.19. It served purely an "investment function" (*id.*), the income from which, under *ASARCO* and *Woolworth*, is not taxable by a nondomiciliary state.

II. THIS CASE CANNOT BE MEANINGFULLY DISTINGUISHED FROM *ASARCO* AND *WOOLWORTH*, WHICH REFLECT SOUND AND SETTLED PRINCIPLES OF CONSTITUTIONAL ADJUDICATION THAT SHOULD NOT BE DISTURBED.

As our opening brief demonstrated, *ASARCO* and *Woolworth* unequivocally rejected the very theory underlying New Jersey's case, namely, that income from intangibles should be considered part of a unitary business whenever the investments serve long-range corporate interests to increase prosperity, add to the company's capital base, and strengthen its overall ability to achieve operational growth or diversification. "This definition of unitary business," the Court declared, "would destroy the concept." *ASARCO*, 458 U.S. at 326. We also showed that the facts here present an even stronger case for holding the taxpayer's investment nonunitary than did the facts of *ASARCO* and *Woolworth*. Allied-Signal Br. 31-34, 1a-4a.

New Jersey and its amici recognize that their position is difficult, if not impossible, to reconcile with *ASARCO* and *Woolworth*. New Jersey seeks to discredit these precedents by asserting that they "are not consistent with the Court's earlier unitary business decisions" (N.J. Br. 23), although it does not call for their overruling but rather purports to distinguish *ASARCO* and *Woolworth* on their facts (N.J. Br. 38-41). With considerably more candor, California and its sister amici directly urge this Court to overturn *ASARCO* and *Woolworth* on the ground that the Court "rejected too hastily 'corporate purpose' as the test," and that " 'corporate purpose,' correctly defined, is the proper standard for determining apportionability." Cal. Am. Br. 20 (emphasis omitted).[2]

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[2] Whatever the merit of California's suggestion, and we submit it has none, the Court should not consider overruling *ASARCO* and

But *ASARCO* and *Woolworth* reflect long-standing and well-considered principles of constitutional adjudication that strike the proper balance between the conflicting interests of taxing states and multistate enterprises, to wit, the states' claim for a fair share of revenue derived from activities carried on within their borders and multistate taxpayers' claim for protection from taxes on income from out-of-state activities having no substantial connection with the taxing state. The accommodation between these competing concerns has been reached over more than a century of litigation (Allied-Signal Br. 19 n.9), and the particular balance struck in *ASARCO* and *Woolworth* and reaffirmed in *Container* faithfully implemented the established constitutional norms.

The groundwork for the line that the Court drew in *ASARCO* and *Woolworth*—between income from out-of-state activities that have a concrete operational connection to the taxpayer's activities in the taxing state and income from out-of-state activities that merely add to the overall riches of the corporation—was laid over half a century earlier in *Wallace* v. *Hines*, 253 U.S. 66, 69-70 (1920) (quoted in *ASARCO*, 458 U.S. at 328, and in *Woolworth*, 458 U.S. at 363). Indeed, the Court had reemphasized this line just two years before *ASARCO* and *Woolworth* in *Mobil*, where it observed that a nondomiciliary state lacks power to tax income from intangibles when "the income was earned in the course of activities unrelated to" the underlying operations of the taxpayer in the state. 445 U.S. at 439. The fundamental principle on which all these cases rest, one that is deeply rooted in this Court's constitutional jurisprudence, is that, in the absence of a substantial connection between income generated from out-of-state activities and the tax-

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Woolworth in this case. The Court ordinarily will not consider arguments advanced only by amici (see, *e.g.*, *Kamen* v. *Kemper Financial Services, Inc.*, 111 S. Ct. 1711, 1717 n.4 (1991); *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752, 761-762 n.7 (1984); *United Parcel Service, Inc.* v. *Mitchell*, 451 U.S. 56, 60 n.2 (1981)), and this principle is especially apt when what amici propose is the overruling of this Court's precedents.

payer's operations in the state, the state has not "given anything for which it can ask return." *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444 (1940) (quoted in *ASARCO*, 458 U.S. at 328; see also *Woolworth*, 458 U.S. at 372).

Other than its distaste for adverse precedent, New Jersey has offered no cogent reason why these well-considered decisions should be disturbed. New Jersey's contention that *ASARCO* and *Woolworth* should not be read to limit the apportionability of income from intangibles to payments from a payor to a unitary payee (N.J. Br. 43-47), makes no difference in this case because there is *no* theory upon which the apportionability of Bendix's income from its investment in ASARCO can plausibly be based.[3]

New Jersey's effort to distinguish *ASARCO* and *Woolworth* on their facts (N.J. Br. 38-41) is wholly unpersuasive. As we have shown, this is a far stronger case for holding the taxpayer's investment nonunitary than

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[3] Consequently, New Jersey's citation to academic authorities who have suggested that the payor-payee test of apportionability ought not be exclusive, and that income from temporary investments of working capital should be apportionable, is beside the point. N.J. Br. 35, 39. Moreover, those very authorities actually support Bendix's position in this case. In commenting on an earlier New Jersey decision, *Silent Hoist & Crane Co.* v. *Director, Division of Taxation*, 494 A.2d 775 (N.J.), cert. denied, 474 U.S. 995 (1985), which, like the decision below, sustained the apportionability of intangible income from out-of-state investment activities that had no operational connection to the taxpayer's New Jersey business activities, they observed:

> Treating such operationally independent businesses as unitary invariably distorts and misattributes income that belongs to one State or another. *Put in terms of the fundamental basis for taxation of corporations, New Jersey provided no protections or benefits to the investment activities, and it incurred no social costs on their account.*

J. Hellerstein & W. Hellerstein, *1989 Cumulative Supplement* S228 to J. Hellerstein, *State Taxation* (1983) (emphasis supplied). In holding Bendix's income apportionable, the court below relied on its dubious decision in *Silent Hoist & Crane*. Pet. App. 14a, 20a.

was either *ASARCO* or *Woolworth*. See Allied-Signal Br. 31-34, 1a-4a. And New Jersey's suggestion that Idaho had conceded that a unitary business relationship between payor and payee was a *sine qua non* of apportionability (N.J. Br. 41) is indefensible in light of the Court's rejection of Idaho's "corporate purpose" argument based on quotations from Idaho's brief and from oral argument. *ASARCO*, 458 U.S. at 325-326.

Finally, New Jersey's claim that *ASARCO* and *Woolworth* are distinguishable because the records in those cases did not support the "corporate strategy" argument that New Jersey now advances is both wrong and irrelevant. It is wrong because ample evidence in the *ASARCO* record showed, for example, that ASARCO's investment in Southern Peru was motivated by an "operational strategy" to secure a source of supply and was based on management expertise in the copper industry. *ASARCO*, 458 U.S. at 320-322; *id.* at 335-337 (O'Connor, J., dissenting). The Court nevertheless found no sufficient operational connection.

Moreover, the argument based on the records of those cases is irrelevant because the Court rejected the states' "corporate purpose" and "adds to the riches of the corporation" arguments as a matter of law, not as a matter of fact. *ASARCO*, 458 U.S. at 326; *Woolworth*, 458 U.S. at 363-64. Whatever ASARCO's purpose may have been, and however significant Woolworth's investments in its subsidiaries may have been to the overall economic stability of the parent, those facts were of no consequence in light of the controlling legal standard—a concrete relationship between in-state operations and out-of-state investments.

III. THE RULE OF LAW IMPLICIT IN THE DECISION BELOW IS UTTERLY UNWORKABLE, EFFECTIVELY JETTISONS ALL CONSTITUTIONAL RESTRAINTS ON STATE TAXATION OF INCOME FROM INTANGIBLES, AND SUBJECTS MULTISTATE BUSINESSES TO INCREASED RISK OF MULTIPLE TAXATION.

The pernicious effect of the decision below is not limited to the fact that it would radically revise the settled understanding of constitutional restraints on state tax power that has existed for decades. It also would create an unmanageable rule of law that would make it impossible to tell whether intangible income from passive investments is apportionable. As a consequence, it would spawn inconsistent treatment of the same transaction by different states, thereby subjecting multistate businesses to an unnecessary and unacceptable risk of multiple taxation.

The unworkable nature of a unitary business definition rooted in "corporate strategy" is well illustrated by New Jersey's attempt to apply it in this case. Under such a definition, so long as a corporation has articulated reasons for acquiring or disposing of an investment, it will have proclaimed a corporate strategy sufficient to render income from that investment apportionable. For example, where Bendix invested in a *related* business such as Martin Marietta, the investment is said to be unitary because it served the corporate strategy of expanding Bendix's existing businesses. N.J. Br. 26. Conversely, under New Jersey's "heads-I-win-tails-you-lose" formulation, Bendix's investment in an *unrelated* business such as ASARCO is said to be unitary because it furthered the announced corporate goal of diversification, protecting Bendix from cyclical downturns in its core businesses. N.J. Br. 6, 25, 29, 42. Along the same lines, the acquisition of *controlling* interests in other enterprises is said to be unitary because it enhanced Bendix's position in its core businesses. N.J. Br. 32. Yet acquiring a *minority* interest in ASARCO is likewise claimed to be unitary because Bendix "reaped additional advantages": "From an operational standpoint, the relatively smaller position

created less exposure to the cyclicality of ASARCO's earnings." N.J. Br. 31. Needless to say, when these earnings were viewed as countercyclical to those in Bendix's core businesses, they are also claimed to serve a unitary purpose, namely, diversification.

And, if there remained any possibility that some of Bendix's investment income might somehow escape apportionment, New Jersey removes it by observing that even the goal of making money would constitute a unitary corporate strategy. Thus, Bendix's investment in ASARCO is claimed to be "essential to the financial management of Bendix' unitary business" because "[o]ne purpose in acquiring what was essentially a large supply of copper was to position Bendix to benefit from an anticipated increase in the world price of copper." N.J. Br. 28. Similarly, one of the roles of top management is claimed to be "the continuous identification of investment opportunities in order to maximize stockholder return from a portfolio of investments." N.J. Br. 37.

If this Court were to embrace the standardless unitary business concept adopted by the court below and defended here by New Jersey and its amici, the law in this area would be left in shambles and multistate businesses would be exposed to uncertain and duplicative tax liabilities. The established and workable constitutional regime reflected in *ASARCO* and *Woolworth* would be replaced by an uncertain and arbitrary regime in which a state's power to tax a corporation would expand (in domiciliary states that benefit from apportionment) or contract (in nondomiciliary states that benefit from allocation) with each annual corporate report or news release. As a practical matter, the "corporate strategy" doctrine would permit nondomiciliary states to sweep virtually all of a taxpayer's investment income into the apportionable tax base on the theory that the investment served the "operational" goals of corporate growth and diversification. At the same time, however, because the "corporate strategy" doctrine is so bereft of meaningful content, domiciliary states could apply it to justify the allocation of the same invest-

ment income to the taxpayer's commercial domicile on the theory that the investment was not part of some "operational" strategy.

Adoption of New Jersey's malleable "test" of apportionability of investment income would therefore dramatically increase the risk that multistate taxpayers would be subjected to duplicative taxation resulting from inconsistent determinations of the apportionability of investment income. State taxing authorities seeking to maximize tax revenues would naturally seek to characterize investment income as allocable or apportionable depending on whether a particular taxpayer was a domiciliary or a nondomiciliary. Under New Jersey's contentless definition of a unitary investment, the taxpayer could not carry its burden of proof to show that either characterization was wrong. While this Court has tolerated some duplicative taxation arising from different state statutory division-of-income methods, *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978), there is no warrant for it to adopt, as a federal constitutional principle, a rule that not only is wholly unmanageable but also unnecessarily exposes interstate businesses to increased risks of multiple taxation.

Moreover, contrary to the suggestions of New Jersey and its amici, the current regime of state taxation of investment income that New Jersey seeks to displace is both workable and fair. The line that this Court has drawn between capital transactions serving an "operational function" and those serving an "investment function" is well established. *Container*, 463 U.S. at 180 n. 19; cf. *Corn Products*, 350 U.S. at 50-53. Under this regime, which is embodied in most states' statutes, investment income that is not operational and therefore may not be apportioned among the states in which a taxpayer does business is allocated in full to the taxpayer's commercial domicile. See Uniform Division of Income for Tax Purposes Act §§ 1(a), 1(e), 6(c), 7, 7A Uniform Laws Annotated 331 (1985); 1 Multistate Corporate Income Tax Guide (CCH) ¶ 145 (1991); *ASARCO*, 458

U.S. at 310-311. The consequence of this Court's decisions restraining nondomiciliary states' power to classify passive investment income as apportionable is simply to permit such income to be taxed by the state of the corporation's commercial domicile, where the investment is ordinarily managed.[4]

Finally, if a sea change is to be made in the law governing state taxation of intangible income earned by multistate enterprises, Congress, not this Court, should make it. Unlike the Court, which has expressed doubts over its institutional competence and constitutional authority to prescribe uniform allocation and apportionment rules, *Moorman*, 437 U.S. at 279-280, Congress has both. Congress is well equipped to weigh the competing considerations that ought to inform the choice of a sound division-of-income rule. Indeed, as Justice Frankfurter once observed, "Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting).

Moreover, this Court has left no doubt that Congress has the requisite power to implement its policy choices in this domain. "It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income." *Moorman*, 437 U.S. at 280. While

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[4] Although Michigan, Bendix's domiciliary state, taxed only an apportioned share of Bendix's investment income, Michigan's value-added taxing scheme bears no resemblance to the typical net income tax imposed by most states. See *Trinova Corp.* v. *Michigan Dep't of Treasury*, 111 S. Ct. 818 (1991). If Bendix had been domiciled in a state other than Michigan, including most of the states that have joined the amicus briefs supporting New Jersey, Bendix's income from its sale of ASARCO would have been taxable in full in its state of domicile.

the constitutional restraints at issue here rest on the Due Process Clause as well as the Commerce Clause, that would not limit the power of Congress to act, at least in matters involving state taxation of interstate commerce. See Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387, 400-401 (1983) (Congress can consent to state laws where constitutional restrictions bind the States but not Congress); Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993, 1022-1028 (1986) (Congress can free the States from due process clause nexus restrictions in regulating state taxation of interstate commerce).

IV. ANY DRASTIC CHANGE IN THE LAW SHOULD BE MADE PROSPECTIVE ONLY.

We appreciate that this Court is divided on the question whether judicial decisions embodying newly announced principles of law may properly be confined to prospective application. For the reasons we have given, we submit that the decision of the New Jersey Supreme Court cannot be upheld except by breaking sharply with the line of authority that culminated in *ASARCO* and *Woolworth*, which represents relatively settled constitutional doctrine. Should the Court accept amici's invitation to take such a drastic step, despite our showing that there is neither a sound theoretical basis nor a demonstrable practical need for such action, its decision will give rise to the question whether the new rule must be given retroactive application to this and other similar cases.

We urge the Court to direct that any such basic change be effective only prospectively, applying solely to tax years commencing after the date of the decision in this case. It is not merely that *ASARCO* and *Woolworth*, by enunciating fundamental principles governing the taxation of multistate enterprises, sent forth to the business and industrial community unmistakable signals concerning constitutionally acceptable state taxing patterns. In

addition, countless tax returns have been prepared and filed throughout the nation in justifiable reliance on the principles enunciated. Some of these returns would still be open to review and revision; others would not. Elemental considerations of fairness, as well as the strong need for uniformity, counsel against disrupting such a vast array of transactions. See *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 106-108 (1971); *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969).

CONCLUSION

For the reasons set forth in our opening brief and in this reply brief, the judgment of the Supreme Court of New Jersey should be reversed with instructions to exclude Bendix's gain from the sale of its ASARCO stock from Bendix's apportionable tax base.

Respectfully submitted,

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FEBRUARY 1992

Supreme Court, U.S.
FILED
JAN 9 1992
OFFICE OF THE CLERK

(4)

No. 91-615

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL, INC. as successor-in-interest to The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ of Certiorari to the Supreme Court of the State of New Jersey

BRIEF OF THE WILLIAMS COMPANIES, INC. AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 3

ARGUMENT 5

CONCLUSION 19

TABLE OF AUTHORITIES

Page

CASES:

ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) 2, 3, 6, 7, 12, 17, 18

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983) 3, 7

Corning Glass Works, Inc. v. Virginia Dep't of Taxation, 241 Va. 353, 402 S.E.2d 35, *cert. denied*, ___ U.S. ___, 112 S.Ct. 227 (1991) 17

Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980) 2, 6, 7

F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982) ..... *passim*

Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425 (1980) 2, 6, 9

Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978) 6

Pledger v. Illinois Tool Works, Inc., 306 Ark. 134, 812 S.W.2d 101, *cert. denied*, ___ U.S. ___, 112 S.Ct. 418 (1991) 17

FEDERAL CONSTITUTIONAL PROVISIONS:

U.S. Const. Amend. XIV, § 1 5

STATE STATUTES:

N.J. Stat. Ann. tit. 54, ch. 10E 4

MISCELLANEOUS:

All States Tax Guide (BNA) 14

State Tax Guide (CCH) 14

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Respondent.

On Writ of Certiorari to the Supreme Court of the State of New Jersey

BRIEF OF THE WILLIAMS COMPANIES, INC. AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, The Williams Companies, Inc., respectfully submits this brief as *amicus curiae* in support of Petitioner, Allied-Signal, Inc.[1] The Williams Companies, Inc. (hereinafter "TWC") is a Delaware corporation and a Fortune 500 company.

[1] The Williams Companies, Inc., has received the written consents of the Petitioner and Respondent to the filing of this brief; those consents have been filed with the Clerk of the Court.

TWC's principal place of business and commercial domicile is in Tulsa, Oklahoma. TWC is the parent company and owner, directly or indirectly, of a number of subsidiary corporations (hereinafter the "TWC Subsidiaries"), which are domestic corporations organized under the laws of various states. Some or all of the TWC Subsidiaries are engaged in commerce in virtually every state and file combined state income tax returns as a unitary business with TWC in fourteen states. Because state tax controversies surrounding the apportionability or allocability of income from minority investments of TWC and/or the TWC Subsidiaries have arisen in the past and will continue to surface, the Due Process rights conferred upon TWC and the TWC Subsidiaries will be directly affected by the resolution of this case.

This case involves the continued survival of this Court's interpretations of the Due Process Clause as articulated in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980) (hereinafter *"Mobil"*), *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980) (hereinafter *"Exxon"*), *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) (hereinafter *"ASARCO"*), and *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354 (1982) (hereinafter *"Woolworth"*). In these cases the Court outlined the "nexus" and "rational relationship" standards which are necessary prerequisites to a state's taxation of interstate income. By improperly construing the principles set forth in this Court's prior decisions, the New Jersey Supreme Court rejected a long-established set of criteria that elucidated the Due Process Clause for thousands of business taxpayers and tax administrators and attempted

to replace it with a rule of law that provides virtually no standards.

If this decision stands, taxpayers throughout the nation will experience significant increases in the costs and burdens of allocation and apportionment of income due to the resulting uncertainty. As corporations that must contend daily with the interpretation and administration of the tax laws of the various states, TWC and the TWC Subsidiaries have a vital interest in the proper disposition of this case.

SUMMARY OF ARGUMENT

The Due Process Clause prevents a state from taxing "value earned outside its borders." *ASARCO*, 458 U.S. at 315. In a series of cases culminating in *ASARCO*, *Woolworth*, and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court articulated the Due Process limits on a state's authority to tax income received by a nondomiciliary business from intangible property. Those cases made it clear that the "linchpin of apportionability" is the unitary business principle. *See, e.g., Woolworth*, 458 U.S. at 362. Moreover, in determining whether a unitary business existed, this Court's decisions have focused on the various elements of the relationship between the investor and the investee.

The New Jersey Supreme Court has applied a radically different approach to this area of the law. The court has taken the position that unitary business income also arises whenever the investment in the underlying

intangible serves a "corporate function." App. 19a.[2] Accordingly, the court required Respondent to apportion Bendix's gain from the sale of its ASARCO stock despite the lack of a unitary relationship between Bendix and ASARCO and based simply on the fact that Bendix had business reasons for selling the stock. Because this holding is contrary to existing Due Process jurisprudence, it should not be permitted to stand.

The Court's decision in this case will have obvious ramifications in nearly every State. The New Jersey Supreme Court has announced an interpretation of the Due Process Clause that would permit virtually all income from intangibles to be apportioned. While such a broad standard clearly is in the interest of Respondent,[3] it would create in an enormous potential for double taxation. Many multistate businesses will find themselves paying tax on 100 percent of income from capital gains to their domiciliary states while paying tax on a percentage of the same income to the other states in which they do business. Under the amorphous standard set forth by the New Jersey Supreme Court, it will be just as easy for a state to contend that income is from the unitary business, and therefore apportionable, as it will be to assert that the same income is "nonbusiness" income allocable entirely

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[2] References to "App." are to the appendix filed with Allied-Signal's Petition for a Writ of Certiorari to the Supreme Court of New Jersey.

[3] Unlike the majority of states, New Jersey apportions all gains and dividends from intangibles and does not allocate such income, even if the taxpayer is domiciled in New Jersey. *See generally* N.J. Stat. Ann. tit. 54, ch. 10E.

to the domiciliary state. *Amicus* TWC has found itself increasingly caught in such binds as states seek to expand their tax bases to compensate for shrinking revenues. Only if this Court reaffirms the existence of substantial Due Process limitations will some degree of certainty return to this area of the law. If *Amicus* TWC and the many similarly-situated businesses are to avoid paying state-level tax twice on the same items of income, the New Jersey Supreme Court's analysis of the law must be rejected.

ARGUMENT

The decision of the New Jersey Supreme Court should be reversed by this Court, because the "standards" used to determine whether the capital gain recognized by Petitioner Allied-Signal on the sale of its stock in ASARCO, Inc. (hereinafter "ASARCO") was unitary business income apportionable to New Jersey are so broad that they constitute no standards at all. By misapplying or actually ignoring requirements established by this Court in *ASARCO* and related cases, apportionment of any part of Petitioner's gain on the sale of its ASARCO stock (hereinafter the "ASARCO Gain") by Respondent violated the Due Process Clause of the United States Constitution. *See* U.S. Const. Amend. XIV, § 1.

A. Due Process Requirements for Taxation

This Court has determined that the Due Process Clause, a primary limit on a state's ability to tax income

generated in interstate commerce, requires (1) a minimum connection or nexus between the taxing state and the activities of an interstate business, and (2) a rational relationship between the income attributed to the state and the intrastate values of the business. *Exxon*, 447 U.S. at 219-20; *Mobil*, 445 U.S. at 436-37; *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272-73 (1978).

The Due Process "nexus" requirement is met if a corporation " 'avails itself of the "substantial privilege of carrying on a business" within the State.' " *Exxon*, 447 U.S. at 220 (quoting *Mobil*, 445 U.S. at 437). If the nexus requirement is met, an item of income may be carved out as an exception to the general rule of apportionability only if the taxpayer can "demonstrate something about the nature of this income that distinguishes it from operating income, a proper portion of which the State concededly may tax." *Id.* at 437-38; *ASARCO*, 458 U.S. at 317-18.

In *Mobil*, this Court considered whether Vermont could apportion and tax dividend income paid to Mobil, a corporation domiciled in New York, by its subsidiaries and affiliates doing business abroad. This Court found that neither the foreign source nor the dividend form of the income destroyed the nexus between the dividends and the State of New York. *Mobil*, 445 U.S. at 437-38. The *Mobil* case focused exclusively on the nexus prong of the dual Due Process requirements, as Mobil "made no effort to demonstrate that the foreign operations of its subsidiaries and affiliates [we]re distinct in any business or economic sense from its petroleum sales activities in Vermont." *Id.* at 439; *see also id.* at 435.

This Court has stated that the other requirement of Due Process, the rational relationship test, looks to the relationship between the income attributed to the state and the intrastate values of the taxpayer's business. The "proper inquiry looks to 'the underlying unity or diversity of business enterprise.' " *Woolworth*, 458 U.S. at 363. A state may apportion "corporate income from corporate activities beyond the state's border" only if the intrastate and extrastate activities form part of a single unitary business. *ASARCO*, 458 U.S. at 319. The out-of-state activities must be related in a "concrete way" to in-state activities. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 166 (1983) (hereinafter "*Container*"). In other words, an exchange of value beyond "the mere flow of funds arising out of a passive investment" is necessary. *Id.*

ASARCO and *Woolworth* rejected broad brush approaches to the "unitary business" concept, which this Court has also called " 'the linchpin of apportionability.' " *Woolworth*, 458 U.S. at 362; *ASARCO*, 458 U.S. at 317. If a unitary business exists, a state may apply its apportionment formula to approximate the income " 'reasonably related' " to the activities within the taxing state. *Exxon*, 447 U.S. at 223.

In *Woolworth* this Court rejected the New Mexico Supreme Court's view that because Woolworth's ownership of certain foreign subsidiaries might improve its credit, business standing, and prestige, a unitary business relationship existed. The Court held that the rational relationship test requires more than that an asset merely "adds to the riches" of a corporation.

> Income, from whatever source, always is a "business advantage" to a corporation. Our cases demand more. In particular, they specify that the proper inquiry looks to "the underlying unity or diversity of business enterprise," *Mobil*, 445 U.S., at 440, 100 S.Ct., at 1233, not to whether the nondomiciliary parent derives some economic benefit – as it virtually always will – from its ownership of stock in another corporation. See *ASARCO*, 458, U.S., at 325-329, 102 S.Ct., at 3113-3115.

Woolworth, 458 U.S. at 363-64.

ASARCO rejected a similar claim made by the State of Idaho. In that case, Idaho argued that intangible assets should be considered a part of a unitary business if the intangible property was " 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.' " 458 U.S. at 326. This Court declared that such a broad definition would "destroy the concept."

> The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" becomes no limitation at all.

Id. (emphasis in original).

For purposes of the unitary business principle, dividends and capital gains are treated in the same manner, because "[o]ne must look principally at the underlying

activity, not at the form of investment, to determine the propriety of apportionability." *Mobil*, 445 U.S. at 440; *ASARCO*, 458 U.S. at 330 (quoting *Mobil*).

In its analysis of the unitary business principle, this Court has identified certain factors that indicate the existence of a unitary business. The factors are "functional integration, centralization of management, and economies of scale." *Mobil*, 445 U.S. at 438; *Woolworth*, 458 U.S. at 364. While such elements existed in *Exxon*, *see* 447 U.S. at 224-25, and in other cases, they were not present in *ASARCO* or in *Woolworth*, and accordingly this Court found that Idaho and New Mexico, respectively, could not tax the income at issue in those cases. In *Woolworth*, for example, each subsidiary autonomously decided its own site selection, merchandise, and advertising, and each had an accounting department and financial staff; moreover, Woolworth engaged in no central purchasing, manufacturing or warehousing of merchandise. *Woolworth*, 458 U.S. at 365.

B. Standards Used by the New Jersey Supreme Court to Justify Apportionment of the ASARCO Gain

In reaching the conclusion that the ASARCO Gain and the gain on the sale of Petitioner's United Geophysical Corporation stock (hereinafter the "UGC Gain") were apportionable to New Jersey, the New Jersey Supreme Court used two radically different sets of criteria. Only the nexus and rational relationship standards used to defend New Jersey's apportionment of the UGC Gain, however, satisfy the Due Process requirements established by this Court. The analysis used by the New Jersey

Supreme Court to justify apportionment of the ASARCO Gain only superficially contains criteria resembling the standards established by this Court. Moreover, the criteria enunciated to defend apportionment of the ASARCO Gain are so vague that they would allow a state to justify apportionment of nearly any item of intangible income or loss of a multijurisdictional business. The New Jersey Supreme Court has added so much elasticity to the Due Process standards developed in decisions of this Court as to render them meaningless.

Although the New Jersey Supreme Court has purported to follow this Court's precedents in the area of interstate taxation, acceptance of the court's reasoning in this case will in essence mean that this Court has altered Due Process standards to conform with the positions rejected in *ASARCO* and *Woolworth*. In those cases and their predecessors, this Court identified the limits on state taxation of interstate income of a nondomiciliary business. The New Jersey Supreme Court, however, has rejected the notion that this Court has articulated a single governing standard based on the unitary business principle; instead, it asserts that "there are *a number of nonexclusive tests* utilized to determine the existence of a unitary business." App. at 15a (emphasis added).

Based on this notion, the New Jersey Supreme Court applied two entirely different tests in its decision. With regard to the UGC Gain (which is not an issue before this Court), the court applied the Due Process tests previously articulated by this Court. The UGC Gain was found to be taxable by Respondent based on indicia of a functionally integrated enterprise (evidence of Petitioner's supervisory role via staffing UGC management and director

positions with Petitioner's personnel, direct and regular reporting by UGC personnel to Petitioner's executive and management personnel in charge of UGC, Petitioner's veto of UGC's effort to terminate UGC's marine exploration program) and financial supervision that reflected a "flow of value" (coverage of UGC employees by Petitioner's workers' compensation plans, participation of UGC employees in Petitioner's employee savings plans, Petitioner's providing of insurance, legal, and tax technical assistance for compensation). App. 17a and 18a.

With regard to the ASARCO Gain, however, the New Jersey Supreme Court asserted that the relationship between Bendix and ASARCO was not controlling. App. 18a. In place of a test based on the degree of interaction between the investor and the investee, the court enunciated a series of vague and indefinite phrases which it attempted to call a standard: "the intangible nature of corporate operations;" "the underlying economic realities as evidenced by the facts;" whether an investment goes "beyond the passive corporate investment;" "the existence of exchange or transfer of value." App. 15a, 16a, 20a. From its application of this "standard" to the facts surrounding Bendix's investment in ASARCO, it is apparent that the New Jersey Supreme Court has proposed a definition of Due Process that would allow states to tax a portion of income from intangibles whenever the intangible property is purchased with a conscious intention to make money. If anything, this is a *broader* unitary business standard than the one rejected in *ASARCO*, wherein Idaho asserted that intangible property should be considered part of the unitary business "when the intangibles contribute to or relate to or are some way in furtherance

of the taxpayer's own trade or business." *ASARCO*, 458 U.S. at 326.

ASARCO and *Woolworth* also appear to be factually indistinguishable from this case, except in that the relationships between the investors and the investees in those cases were in many ways *closer* than the relationship between Bendix and ASARCO. The New Jersey Supreme Court's attempts to reconcile its decision with these cases were so conclusory and narrow as to appear cynical. The court noted that "ASARCO's stock investments were 'not integral to nor a necessary part of [ASARCO's] business operations' " and that "in neither *ASARCO* nor *F. W. Woolworth* did the taxing State produce any facts that demonstrated the minimal contacts and rational relationships required to satisfy constitutional restraints." App. 21a. In other words, the New Jersey Supreme Court simply said that *ASARCO* and *Woolworth* do not support the conclusion that Bendix and ASARCO were not unitary because the taxpayers and the investees in those cases were not unitary. Alternatively, the court distinguished *ASARCO* and *Woolworth* on the grounds that "neither *ASARCO* nor *F. W. Woolworth* involved the purchase of 4,000,000 shares of outstanding corporate stock to enhance the stockholder value in the corporation." App. 21a. By its having suggested that *ASARCO* and *Woolworth* are applicable only to the *precise* sets of facts contained in those two cases, it is clear that the New Jersey Supreme Court believes that *ASARCO* and *Woolworth* have essentially no precedential weight.

C. The Danger in the Allied-Signal Standards

If this decision is not reversed, a number of negative results are likely to occur. The New Jersey Supreme Court's amorphous Due Process standards will no doubt result in a rash of tax assessments seeking the apportionment of income from minority investments in intangibles by states in which the multijurisdictional taxpayer/owner is not domiciled. Apportionment of income allocated to the taxpayer's commercial domicile will result in double taxation of the same income in many situations.[4] Failure to reverse the elastic Due Process standards urged by the

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[4] Of the 46 states which tax corporate income, 34 allocate (*i.e.*, tax 100% of the income from) gains realized by domiciliary corporations from intangible property in at least some instances: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Minnesota, Mississippi, Missouri, Montana, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Utah, West Virginia, and Wisconsin. Virginia and the District of Columbia allocate some corporate income, but do not allocate income from intangibles. New Jersey is one of only 11 states that exclusively apportion gains from intangibles; the others are Connecticut, Maine, Maryland, Massachusetts, Michigan, Nebraska, New Hampshire, New York, Rhode Island, and Vermont.

Similarly, 31 states and the District of Columbia allocate dividends from intangibles in at least some instances: Alabama, Alaska, Arizona, Arkansas, California, Colorado, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, New Mexico, North Carolina, North Dakota,

(Continued on following page)

New Jersey Supreme Court in this case also would cultivate fertile ground for a corollary problem: the same states will be able to increase a taxpayer's apportionable income by arguing that a capital loss generated from a similar minority investment is allocable to the taxpayer's commercial domicile.

The potential for abuse created by the Due Process standard used by the New Jersey Supreme Court in this case is clearly evident. Despite the court's repeated assertions that apportionability is determined by the "underlying economic reality" or the "facts or underlying economic activities" concerning the taxpayer and the investee, the court chose to ignore the "facts" and the "reality" of the relationship (or lack thereof) between Bendix and ASARCO. Instead, the New Jersey Supreme Court focused on Bendix's intended use of the proceeds from the ASARCO stock sale – an intention that was ultimately never acted upon. The court below has sought to shift the unitary business test from the ascertainable facts of the investor-investee relationship to a vague, motive-based inquiry that conceivably could be used to

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(Continued from previous page)

Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, and West Virginia. Connecticut, Delaware, Maine, Maryland, Massachusetts, Nebraska, New Hampshire, New Jersey, New York, Rhode Island, and Vermont exclusively apportion such dividends, while Kentucky, Michigan, Pennsylvania, and Wisconsin exclude dividends from taxable income. *See generally*, All States Tax Guide (BNA) ¶ 223 and specific state entries; State Tax Guide (CCH) ¶ 10-110 and specific state entries.

justify apportionment of virtually any item of income from intangibles.

Companies frequently buy and sell interests in other companies for various reasons. A conglomerate will often buy or sell a subsidiary, a line of business or a segment of its vertically integrated unitary business. These sales occur due to a lack of profitability, to allow expansion into another area of the taxpayer's business, to develop a new line of business, or for numerous other reasons. Occasionally, an attractive minority stock investment opportunity appears. It is often a necessity that the proceeds from these stock sales are used to fund the operational or capital needs of the selling corporation. The New Jersey Supreme Court focused on the vague concept it labelled Petitioner's "investment policy." By lumping **all** of a taxpayer's investment transactions together without examining the underlying unity or diversity of the taxpayer and each investee, a state taxing authority will *always* be able to conclude that the taxpayer has a business function of corporate acquisitions and divestitures that is a long-term integral operational activity of the taxpayer. *See* App. 19a. Income from such an "investment policy" will automatically become apportionable to that state.

The notion that an investment policy reflects an ordinary business practice that somehow "goes beyond the focus" on the existence of a functional or managerial relationship between the taxpayer and an affiliate (*see* App. 19a and 20a) opens a pandora's box of creative apportionment theories. If a taxpayer's "investment policy" can satisfy both the nexus and rational relationship

Due Process requirements (*see* App. 20a), almost anything will satisfy them.

Other unfavorable results are likely to emanate from the inevitable flurry of state tax litigation if this case is not reversed. Findings that more than one taxpayer is unitary with a single investee will be likely in situations where none of the shareholders has any opportunity to control or significantly influence the investee and no other "traditional" unitary business indicators are present. For example, assume Taxpayer I owns 30% of Corporation I, Taxpayer II owns 30%, Taxpayers III and IV each own 15%, and Taxpayer V owns 10%. Under the rationale of the case at bar, all taxpayers could be deemed to have a unitary relationship with Corporation I. Such a result would make the term "unitary business" an absurdity.

By finding that a taxpayer's investment policy created both nexus and a rational relationship with all nondomiciliary states, all income from the taxpayer's stock investments could be deemed apportionable. A capital gain could then be subjected to double taxation if the taxpayer's commercial domicile deemed the gains to be allocable. Uncertainties created by the ability of state taxing authorities to manipulate or ignore traditional Due Process requirements of apportionability set by this Court will make multijurisdictional state tax planning more like a game of Russian roulette. Future capital investment or expansion in interstate commerce could, therefore, be disrupted by corporations wary of these dismal possibilities.

As this Court is aware, courts in other states do not share the New Jersey Supreme Court's expansive interpretation of the unitary business concept. This Court has recently denied certiorari in two cases in which courts have relied on *ASARCO* and *Woolworth* to overturn efforts to tax capital gains realized by nondomiciliary taxpayers. *Corning Glass Works, Inc. v. Virginia Dep't of Taxation*, 241 Va. 353, 402 S.E.2d 35, *cert. denied*, ___ U.S. ___, 112 S.Ct. 227 (1991); *Pledger v. Illinois Tool Works, Inc.*, 306 Ark. 134, 812 S.W.2d 101, *cert. denied*, ___ U.S. ___, 112 S.Ct. 418 (1991). The Virginia and Illinois courts both focused on the taxpayer-investee relationship in determining that the gains at issue in those cases were not unitary business income. Failure to reverse the New Jersey Supreme Court's decison in this case would at the very least send a conflicting message as to the continuing existence of substantial Due Process limitations on state taxation of interstate income.

Regardless of whether this Court chooses to uphold Respondent's taxation of the ASARCO Gain, *Amicus* TWC urges the Court to seize the opportunity presented by this case to provide guidance in the area of state taxation of interstate income. If this Court reverses the New Jersey Supreme Court's decision, it is important that this Court's opinion be firm enough to withstand attempts by states to distinguish this case based on insignificant factual differences. If instead this Court fails to reverse the court below, it should enunciate the analytical guidelines that are missing from the New Jersey Supreme Court's opinion.[5] While *Amicus* TWC strongly believes that the Due

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[5] Should this Court decide in favor of the Respondent, it should also be prepared to confront, either in this case or in the

(Continued on following page)

Process Clause requires a decision in favor of Petitioner in this case, TWC primarily desires that this case result in increased clarity for taxpayers who must deal with the constant threat of double taxation at the state level.

(Continued from previous page)

near future, the issue of what limits (if any) the Due Process Clause imposes on *allocation* of income by a business' state of domicile. As *Amicus* TWC has noted throughout this brief, the Due Process standards urged by Respondent will undoubtedly lead to increasing instances of double taxation; despite earlier pleas by this Court for federal legislative action to create some degree of uniformity at the state level (*see, e.g., ASARCO*, 458 U.S. at 331 (Burger, concurring)), little if any movement in this direction has occurred, nor does any seem likely in the near future.

CONCLUSION

For the foregoing reasons, the decision of the Supreme Court of the State of New Jersey should be reversed.

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January 9, 1992

FILED
JAN 10 1992
OFFICE OF THE CLERK

No. 91-615

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

ALLIED-SIGNAL INC.
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

	Page
INTRODUCTORY STATEMENT	1
INTEREST OF *AMICUS CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT	4
DUE PROCESS AS APPLIED IN THE DECISIONS OF THIS COURT PREVENTS A NONDOMICILIARY STATE FROM TAXING INCOME RECEIVED FROM INVESTMENTS IN NONUNITARY CORPORATIONS	4
CONCLUSION	10

TABLE OF AUTHORITIES

CASES: Page

Arizona v. Rumsey, 467 U.S. 203 (1984) 7
ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982) 2, 3, 4, 5, 6, 8, 9
Bass, Ratcliff & Gretton, Limited v. State Tax Commission, 266 U.S. 271 (1924) 2
Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983) 3, 4, 6, 7
Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980) 2, 4, 5, 6
Payne v. Tennessee, 111 S.Ct. 2597 (1991) 7
Smith v. Allwright, 321 U.S. 649 (1944) 7
F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico, 458 U.S. 354 (1982) 2, 3, 4, 5, 6, 9

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a nonprofit association, which was separately incorporated on January 1, 1992. COST was originally organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST's membership consists of 365 major multistate corporations. COST member companies

conduct a substantial portion of the interstate commerce of United States taxpayers and are representative of that part of the nation's business sector which is directly affected by state taxation of interstate operations.

COST's objectives include the preservation and promotion of equitable and nondiscriminatory methods of state taxation of multistate businesses and the promotion of proper methods of assigning values, income and taxable incidents among the states. The decision of the New Jersey Supreme Court clearly impinges on these goals.

Under the decision of the New Jersey Supreme Court, the Due Process restraints on the states' power to tax investment income of nondomiciliary corporations have been eviscerated. Every COST member corporation has passive investment income which is unrelated to its business activity outside of its domiciliary state. Therefore, COST has a vital interest in this case.

SUMMARY OF ARGUMENT

This Court has set forth the limits required by the Due Process Clause on a state's power to impose its income tax on intangible investment income of a nondomiciliary corporation. First, the Due Process Clause prohibits a state from taxing value earned outside its borders. *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 315 (1982). Out-of-state income may, however, be included in income subject to state apportionment if it arises from a unitary business. *Bass, Ratcliff & Gretton, Limited v. State Tax Commission*, 266 U.S. 271, 282 (1924). The "unitary business principle" is "the linchpin of apportionability in the field of income taxation". *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 439 (1980). Most important to the instant case, in *ASARCO, supra* and *F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982), this Court specifically addressed the taxation of intangible investment income and

rejected a definition of a unitary business that focused on the internal potential economic and business advantages to the taxpayer from its investments in other corporations. Rather, this Court held that dividends, interest and capital gains received by nondomiciliary corporations could not be taxed where the income was derived from "discrete business enterprises", *Woolworth*, 458 U.S. at 372, which in "any business or economic sense" had "nothing to do with the activities" of the corporations in the taxing state. *ASARCO*, 458 U.S. at 328. Thus, as framed by this Court, the issue in determining whether intangible income such as dividends, interest and capital gain income is subject to appointment is whether a unitary relationship exists between the nondomiciliary taxpayer and entities from which the intangible income was derived.

This Court reaffirmed its decisions in *ASARCO* and *Woolworth* in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), noting that "[t]he legal principles defining the constitutional limits on the unitary business principle are now well established." 463 U.S. at 176. This Court further stated

> [T]he principles we have quoted require that the out-of-State activities of the purported "unitary business" be related in some concrete way to the in-State activities. The functional meaning of this requirement is that there be some sharing or exchange of value . . . beyond the mere flow of funds arising out of a passive investment or a distinct business operation . . . 463 U.S. at 166.

A nondomiciliary corporation's management of investments outside the state has no concrete connection to the conduct of its active business operations within a state. This Court has recognized and reaffirmed this in its unitary decisions.

In order to affirm the decision of the New Jersey Supreme Court, this Court would have to overrule its decisions in *ASARCO* and *Woolworth*. The State has stipu-

lated that while Bendix held its investment in ASARCO, Bendix and ASARCO were unrelated business enterprises each of whose activities had nothing to do with the other; and that none of ASARCO's activities, businesses or income were related to or connected with Bendix's activities, business or income. Stip. ¶¶ 62, 41. Under the holdings of this Court, the investment income received by Bendix, a nondomiciliary corporation, which was derived from the sale of its minority interest in a *nonunitary* corporation cannot be subject to apportionment consistent with Due Process. Therefore, the decision of the New Jersey Supreme Court must be reversed.

ARGUMENT

DUE PROCESS AS APPLIED IN THE DECISIONS OF THIS COURT PREVENTS A NONDOMICILIARY STATE FROM TAXING INCOME RECEIVED FROM INVESTMENTS IN NONUNITARY CORPORATIONS

Under the Due Process Clause principles as developed by this Court in *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 354 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982); and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), a State may not tax income received by a nondomiciliary corporation from a passive investment in a nonunitary corporation. The application of these principles to the instant case demands the reversal of the decision of the New Jersey Supreme Court.

In *Mobil*, *supra*, this Court enunciated the general principle which prohibits a state's taxation of extraterritorial income, stating that "the linchpin of apportionability . . . is the unitary business principle." 445 U.S. at 439. The due process limitations are not contravened "so long as the intrastate and extrastate activities form[] part of a single unitary business." 445 U.S. at 438.

Although in *Mobil* this Court held that the taxpayer was unitary with its foreign subsidiaries so that the dividends received from the subsidiaries could constitutionally be included in apportionable income, this Court cautioned

> We do not mean to suggest that all dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where the corporation does business. *Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State*, due process considerations might well preclude apportionability because there would be no underlying unitary business. 445 U.S. at 441-442 (emphasis added).

In *ASARCO* and *Woolworth*, this Court rejected the states' attempt to apportion and tax dividends, interest and capital gain income received by nondomiciliary parent corporations because the income was derived from "discrete business enterprises", *Woolworth*, 458 U.S. at 372, which in "any business or economic sense" had "nothing to do with the activities" of the parent corporation in the taxing state. *ASARCO*, 458 U.S. at 328.

Moreover, in *ASARCO* and *Woolworth*, this Court noted that the state courts had applied an improper legal standard, focusing on the internal potential economic and business advantages to the parent corporations deemed to arise from parent-subsidiary relationships. In *ASARCO*, this Court rejected the state's position that an internal corporate purpose should define a unitary business or that intangible income should be considered a part of a unitary business if the shares of stock are acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business. However, it is this very "corporate purpose" test which the New Jersey Supreme Court wishes to adopt, even though this Court stated

> [t]his definition of unitary business would destroy the concept. The business of a corporation requires

> that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. *ASARCO*, 458 U.S. at 326 (emphasis and brackets in original).[1]

In *Woolworth*, this Court further stated that the due process limitation would be trivialized

> by holding it satisfied if the income in question "adds to the riches of the corporation . . ." *Wallace v. Hines*, 253 U.S. 66, 70 (1920). Income from whatever source, always is a "business advantage" to a corporation. *Our cases demand more. In particular, they specify that the proper inquiry looks to "the underlying unity or diversity of business enterprise," Mobil, supra*, at 440, *not to whether the nondomiciliary parent derives some economic benefit—as it virtually always will—from its ownership of stock in another corporation.*" 458 U.S. at 363-364 (emphasis added).

Within the different context of applying formulary apportionment to the combined income of worldwide affiliates, in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court reviewed and affirmed the principles articulated in its prior unitary cases, stating

> *[T]he principles we have quoted require that the out-of-State activities of the purported "unitary busi-*

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[1] This Court also held in *ASARCO* that in considering whether income from investments can be constitutionally included in apportionable income, the same due process analysis is applied to capital gain income that is applied to dividend income. This Court stated that "[c]hanging the form of the income 'works no change in the underlying economic realities of [whether] a unitary business [exists], and accordingly it ought not to affect the apportionability of income the parent receives.' [citation omitted]." 458 U.S. at 330.

> *ness" be related in some concrete way to the in-State activities. The functional meaning of this requirement is that there be some sharing or exchange of value* not capable of precise identification or measurement—*beyond the mere flow of funds arising out of a passive investment or a distinct business operation* —which renders formula apportionment a reasonable method of taxation. 463 U.S. at 166 (emphasis added).

In determining whether there was a "sharing or exchange of value" in *Container*, this Court focused on the relationship between Container and its foreign subsidiaries—not upon the relationship between Container's business operations and its investment activities—thus following the focus of this Court's inquiry in *ASARCO* and *Woolworth*.

The due process principle that has been consistently applied by this Court in *Mobil*, *ASARCO*, *Woolworth* and *Container* is that a State may not tax intangible income, including dividends, interest and capital gain income, received by a nondomiciliary corporate taxpayer unless a unitary relationship exists between that taxpayer and the entities in which it invested and from which the investment income was derived. In order to affirm the decision of the New Jersey Supreme Court this Court would have to overrule its prior decisions establishing this due process limitation. The "overruling a precedent of this Court is a matter of no small import, for 'the doctrine of stare decisis is of fundamental importance to the rule of law.' *Welch v. Texas Dept. of Highways and Public Transportation*, 483 U.S. 468, 494 (1987)." *Payne v. Tennessee*, 111 S. Ct. 2597, 2617 (1991) (Scalia, concurring).

Such a departure from precedent requires some "speeal justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984), particularly where an established constitutional principle is concerned. *Smith v. Allwright*, 321 U.S. 649,

666 (1944). Additionally, considerations in favor of stare decisis are given the greatest weight in the commercial arena, such as is involved in the instant case. *See*, *Payne*, *supra* at 2610. There simply is no special justification for departing from the constitutional standards set forth by this Court in *Mobil*, *ASARCO*, *Woolworth*, and *Container*. To do so by adopting New Jersey's "corporate purpose" definition of the unitary business doctrine "would destroy the concept", *ASARCO*, 458 U.S. at 326, as well as destroy the protection intended by the Due Process Clause.

It is not surprising that the states wish to destroy the unitary business concept thereby allowing them to reach the large pool of income resulting from corporate investment activities. Bendix, of course, is not unique in corporate America. Every major corporation has engaged and continues to engage in investment activities that are intended to result in some economic benefit. One could look at the annual reports of every COST member corporation and see language to that effect. However, this type of investment income has no functional connection, in any business or economic sense, with the actual business operations of corporations in nondomiciliary states.

Bluntly stated, the logic of the position taken by the court below suggests that only equity investments by irrational investors—that is, investments made with no knowledge of the issuer, for no apparent business purpose, and for which for all practical purposes are neither monitored nor supervised by the taxpayer—can qualify as "passive" and, therefore, "nonunitary business" investments. Merely framing the issue in terms of the relationship between the taxpayer's business activities and its investment activities would be, without further analysis, effectively dispositive. Absent corporate waste, investment income necessarily "add[s] to the riches" of the corporate investor and, therefore, can be said to be "for

purposes related to or contributing to the [corporation's] business." *ASARCO*, 458 U.S. at 326, 328. Absent mismanagement or a "blind pool", every equity investment of a corporate investor will, to one degree or another, be monitored and supervised and, with respect to the investment itself, will be controlled by the corporate investor. Obviously, the corporate investor enters into such transactions with the intent of earning income. However, "whether the nondomiciliary [corporation] derives some economic benefit—as it virtually always will—from its ownership of stock in another corporation" is not the proper inquiry in determining whether income arose from a unitary business. *Woolworth*, 458 U.S. at 363-364. The unitary test proposed by New Jersey asks no more than whether the "income in question 'adds to the riches of the corporation' ". *Id.* Thus, that test is not only contrary to the decisions of this Court, but, in application, is no test at all.

The continued viability of the unitary concept is an issue of major importance to corporate taxpayers. Virtually every major corporation is impacted by the attempts by nondomiciliary states to reach income resulting from passive investments. Taxpayers have continually relied on *ASARCO* and *Woolworth* as those decisions clearly set forth the Due Process limitations on the states' ability to tax income received by nondomiciliary corporations from the investment in unrelated, nonunitary businesses. The decision of the New Jersey Supreme Court flies in the face of these decisions and must be reversed.

CONCLUSION

For the foregoing reasons, the Committee on State Taxation respectfully requests that the decision of the New Jersey Supreme Court be reversed.

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Dated: January 10, 1992

Supreme Court, U.S.
FILED
FEB 10 1992
OFFICE OF THE CLERK

No. 91-615

In the Supreme Court of the United States.

October Term, 1991

ALLIED-SIGNAL, INC.,
as successor-in-interest to
THE BENDIX CORP.,
Petitioner,

v.

DIRECTOR, NEW JERSEY
DIVISION OF TAXATION
Respondent.

ON WRIT OF CERTIORARI TO
THE SUPREME COURT OF NEW JERSEY

BRIEF FOR AMICI CURIAE MASSACHUSETTS, CONNECTICUT, MARYLAND and VIRGINIA SUPPORTING RESPONDENT

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TABLE OF CONTENTS

	Page
INTEREST OF AMICI CURIAE	2
ARGUMENT	5
I. THE COURT BELOW APPLIED THE CORRECT LEGAL STANDARD WHEN IT JUDGED WHETHER BENDIX' INVESTMENT WAS PART OF A UNITARY BUSINESS STRATEGY OF ACQUISITION AND DIVESTITURE.	5
II. THE COURT BELOW MADE A "PERMISSIBLE JUDGMENT" THAT BENDIX' INVESTMENT IN ASARCO WAS PART OF ITS "UNITARY" BUSINESS.	11
CONCLUSION	18

TABLE OF AUTHORITIES

Cases	Page
ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982)	9
Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983)	6, 7, 14
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)	5, 6
Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978)	6

MASSACHUSETTS GENERAL LAWS

	Page
M.G.L. Ann. c. 63, §§ 30, 33 and 39A (West 1988 ed. and 1991 Supp.)	3

MISCELLANEOUS

United States Supreme Court Rule 37.5	2

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ON WRIT OF CERTIORARI
TO THE SUPREME COURT OF NEW JERSEY

BRIEF FOR AMICI CURIAE MASSACHUSETTS, CONNECTICUT, MARYLAND and VIRGINIA SUPPORTING RESPONDENT

The Commonwealths of Massachusetts and Virginia and the States of Connecticut and Maryland, through their Attorneys General, submit this brief

amici curiae in support of respondent Director, Division of Taxation, State of New Jersey. No consent to this filing is required. United States Supreme Court Rule 37.5.

INTEREST OF AMICI CURIAE

The issue presented in this case is whether a State may constitutionally tax a non-domiciliary corporation doing business in the State, on an apportioned percentage of the income derived by the corporation from a minority stock investment, where the investment is integral to the corporation's operational strategy, but where there is no functional integration between the corporation and the entity in which the minority stock investment is held.

Amici have a substantial interest in this issue. Hundreds of non-domiciliary corporations conduct business in the amici States, and are subject to tax on the income attributable to that business. See, e.g., Mass. Gen. Laws Ann. c. 63, §§ 30, 33 and 39A (West 1988 ed. and 1991 Supp.). For example, the Massachusetts corporate excise tax is substantially similar to the New Jersey tax at issue in this case. The Massachusetts tax, like the New Jersey tax, includes in its measure all income derived from the unitary business activities of non-domiciliary corporations, subject to apportionment under a formula used to approximate the income derived from business conducted in Massachusetts.

Corporate taxpayers routinely claim that amici may not include investment income in the apportionable income absent proof that (1) the taxpayer holds a controlling interest in the investment entity, and (2) "functional integration" exists between the taxpayer's operations and those of the investment entity. In Massachusetts alone, corporations currently seek approximately $100 million in state tax abatements on these grounds and the similar grounds argued by the petitioner in this case. A decision in this case therefore may have a profound impact on the fiscal health of the amici. For the reasons stated below, the decision of the Supreme Court of New Jersey should be affirmed.

ARGUMENT

I. THE COURT BELOW APPLIED THE CORRECT LEGAL STANDARD WHEN IT JUDGED WHETHER BENDIX' INVESTMENT WAS PART OF A UNITARY BUSINESS STRATEGY OF ACQUISITION AND DIVESTITURE.

The New Jersey Supreme Court applied the correct legal standard in this case. The court determined whether Bendix' investment in ASARCO was part of a unitary business strategy of acquisition and divestiture. This standard was fully consistent with the Constitution and prior decisions of this Court.

In order to tax the income of multi-jurisdictional corporations, a State must observe restrictions imposed by the Due Process and Commerce Clauses of the Constitution. See Mobil Oil

Corp. v. Commissioner of Taxes, 445 U.S. 425, 436, 443 (1980). For example, a State may tax income only if there is "a 'minimal connection' between the interstate activities and the taxing State[.]'" Id. at 436-37 (quoting Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-273 (1978)). This requirement is met if the income taxed is derived from a "unitary business." See Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439.

The Court addressed the "unitary business" principle most recently in Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983). Container Corp. requires that "the out-of-state activities of the purported 'unitary business' be related in some concrete way to the in-state

activities." Id. at 166. "The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement -- beyond the mere flow of funds arising out of a passive investment or a distinct business operation -- which renders formula apportionment a reasonable method of taxation." Id. (citations omitted).

Under this standard, the Court presumes that the state tax is constitutional. Id. at 170, 175. Thus, the Court will not turn "every colorable claim that a state court erred in a particular application of [unitary business] principles into a de novo adjudication[.]" Id. at 176 (footnote omitted). Instead, the Court will, "if

reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a 'unitary business.'" Container Corp., 463 U.S. at 175.

The New Jersey Supreme Court ruled that Bendix' investment in ASARCO was sufficiently related to the unitary business of Bendix to permit New Jersey to include income derived by Bendix from the investment in the income subject to apportionment. The court held that "[w]hen capital investment activities are long-term integral operational corporate functions rather then passive investment functions, they can serve as the basis for concluding a unitary business exists." Pet. 19a.

This holding is consistent with the Constitution and decisions of this

Court. The New Jersey Supreme Court recognized that investments often "have as their goals the growth and expansion of existing corporate business activities. . . . " Id. The court held that investment decision-making that is substantially related to the pursuit of other business goals may reflect a unitary business strategy and justify unitary tax treatment.

The economic realities invoked by the New Jersey Supreme Court are well illustrated by a comparison of the tax treatment of a stock investment and long-term debt. Long-term borrowings are routinely treated as integral to a unitary business "justifying the deduction of interest expense in the computation of apportionable net income." ASARCO, Inc. v. Idaho State

Tax Commission, 458 U.S. 307, 339 (1982) (O'Connor, J., dissenting). Indeed, in this case, Bendix' Chief Executive Officer made no distinction between investments financed by "excess cash, or excess borrowing capacity." In fact, he urged that investments of the ASARCO type be undertaken whenever available cash or excess debt capacity permitted. (J.A. 135). Here, Bendix financed at least a portion of its acquisition of ASARCO stock from borrowings. Pet. 41a. There is no evidence in the record that Bendix excluded the resulting interest expense in computing its apportionable income for 1981 or the prior years. Nonetheless, Bendix now contends that the income generated from the very same investment must be excluded in computing its income subject to apportionment.

The test applied by the New Jersey Supreme Court would treat income and interest expense consistently. The test applied below would permit a taxpayer to deduct its interest expense but require it to include the income on its investment, where both interest expense and income are part of a centralized and unitary corporate strategy. Nothing in the Constitution forecloses the use of this test.

II. THE COURT BELOW MADE A "PERMISSIBLE JUDGMENT" THAT BENDIX' INVESTMENT IN ASARCO WAS PART OF ITS "UNITARY" BUSINESS.

The New Jersey Supreme Court ruled that Bendix' investment in ASARCO was part of a unitary business strategy of acquisition and divestment. This ruling

was amply supported by undisputed facts in the record.

Bendix, by virtue of its minority stockholdings in ASARCO, gained two seats on the ASARCO Board of Directors. One of the seats was held by Bendix' chief executive officer, who reported regularly to Bendix on the performance of the ASARCO investment.

The ASARCO investment was motivated at least in part by Bendix' need for good cash flows "to meet growing capital needs, particularly in aerospace [and] electronics to permit it to hold its own in stiffening markets." (J.A. 120). Bendix planned that strong profits from its investment would further its long range growth and acquisition planning. (J.A. 87). Bendix also planned to gain an inside view of ASARCO's business

while it weighed a more substantial foray into the nonferrous metal industry. (J.A. 104).

Bendix also considered its 20% ownership interest sufficient to provide it considerable influence on the ASARCO board. (J.A. 104). Bendix' Chairman and Chief Executive Officer, Mr. Agee, observed that with a 20% interest and "friendly relations, our insights and judgments will be recognized. Our shareholdings [will] always make us a force to be reckoned with." (J.A. 128).

The decision to place Mr. Agee on the ASARCO Board of Directors likewise was intended to increase Bendix' influence and further Bendix' strong centralized management of its businesses. Thus, after Bendix purchased the ASARCO stock, Mr. Agee

personally managed Bendix' investment in the same personal manner in which he managed Bendix' operational units. E.g., J.A. 31-33. This evidence amply supported the judgment of the court below that Bendix' acquisition and use of its ASARCO Stock went well beyond a "passive investment." Container Corp. of Am., 463 U.S. at 166. See J.A. 83 (Bendix conceded that its investment was not passive in the sense of an investment in a mutual fund).

Nor did Bendix meet its burden to show that its investment in ASARCO was one in a "distinct business" segregated from its unitary business. Container Corp., 463 U.S. at 166. The Court has required that a taxpayer make a showing by "clear and cogent evidence" on this point. Id. at 175. At most, Bendix

showed that it had no direct relationship to ASARCO's operations. The record, however, amply supported the ruling below that Bendix' ASARCO investment was an integral part of a unitary business strategy of acquisition and divestment. (J.A. 189). For example, the acquisition of ASARCO stock was touted in Bendix' 1978 Annual Report as the single largest investment in company history and one which strengthened Bendix by "a substantial diversification into nonferrous metals and minerals". (J.A. 190). Similarly, Bendix' decision to sell its ASARCO stock furthered its unitary business strategy of acquisition and divestment. "[I]t was the convergence of several kinds of interlocking and interrelated decisions that caused [Bendix] to

consider [the sale of ASARCO stock]". (J.A. 62) (testimony of Mr. Agee). Bendix' plans to acquire Martin Marietta played a major role in its decision to sell the ASARCO holdings. (J.A. 77-81). According to Mr. Agee, Martin Marietta would be a "complementary" business which would "deepen[]" Bendix' "commitment to the aerospace industry." Pet. 11a. The recommendations to sell ASARCO stock and acquire Martin Marietta were made by Bendix' corporate planning department and approved by its president. (J.A. 78-80). Bendix sold its ASARCO stock in order to finance a larger corporate acquisition of a new business closer to its core business.

The above evidence show that Bendix failed to meet its burden to show that its decisions to buy and sell its ASARCO

holdings were mere passive investments or divestments segregated from its unitary business. Indeed, though the state bore no burden of proof, it was New Jersey which produced "clear and cogent" evidence that Bendix was conducting a unitary business. Thus, the New Jersey Supreme Court correctly held that Bendix' investment in ASARCO was part of its unitary business strategy of acquisition and divestment. New Jersey therefore properly included Bendix' gain on the sale of its ASARCO stock in the income subject to apportionment.

CONCLUSION

For the reasons stated above, the decision of the New Jersey Supreme Court should be affirmed.

Respectfully submitted,

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FILED
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OFFICE OF THE CLERK

No. 91-615

In The
Supreme Court of the United States
October Term, 1991

Allied-Signal, Inc., as successor-in-interest
to The Bendix Corporation,
Petitioner

v.

Director, Division of Taxation,
Respondent

On Writ of Certiorari to the Supreme Court
Of the State of New Jersey

BRIEF OF AMICI CURIAE ON THE MERITS IN SUPPORT OF DIRECTOR, DIVISION OF TAXATION OF THE STATE OF NEW JERSEY BY THE STATE OF CALIFORNIA AND THE STATES OF FLORIDA, IDAHO, KANSAS, MONTANA, NORTH DAKOTA, PENNSYLVANIA, UTAH AND WISCONSIN

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QUESTIONS PRESENTED

1. Whether the Due Process and Commerce Clauses preclude a state from apportioning income that a nondomiciliary corporation derives from the sale of its minority interest in another corporation, when the two corporations are not engaged in a unitary business and when the taxpayer fails to show that the holding of the minority interest arose as the result of activities discrete from the unitary business, a portion of which was carried on in the taxing state.

2. Whether this Court should now clarify, or should additionally articulate, the criteria it has set forth in *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and related cases.

TABLE OF CONTENTS

		Page
QUESTIONS PRESENTED		i
TABLE OF AUTHORITIES		iii
INTEREST OF AMICI CURIAE		1
STATEMENT PURSUANT TO RULE 37		3
SUMMARY OF ARGUMENT		3
I	INTRODUCTION	6
II	THE DETERMINATION OF WHETHER INCOME IS BUSINESS INCOME, OR APPORTIONABLE, IS MADE SOLELY BY REFERENCE TO THE RELATIONSHIP OF THE ITEM OF INCOME TO THE TAXPAYER'S ACTIVITIES	10
III	THE PETITIONER HAS NOT ESTABLISHED THAT THE CAPITAL GAINS HERE AT ISSUE AROSE FROM A DISCRETE BUSINESS ENTERPRISE CONDUCTED BY PETITIONER	21
IV	THIS COURT NEEDS TO CLARIFY THE CONFUSION CREATED BY ITS DECISION IN *ASARCO*	26
CONCLUSION		29

TABLE OF AUTHORITIES

Page(s)

CASES:

Amerada Hess Corp. v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989) 14

American Home Products Corp. v. *Limbach*, 49 Ohio St. 3d 158, 551 N.E.2d 201 (Oh. 1990) 13, 27

American Smelting & Refining Co. v. *Idaho State Tax Com.*, 102 Idaho 38, 624 P.2d 946 (1981) 2, 15

American Telephone & Telegraph v. *Wisconsin Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629 (Wis. 1988) 27

ASARCO Inc. v. *Idaho State Tax Commission*, 458 U.S. 307 (1982) . . . . . *passim*

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Lone Star Steel Co. v. *Dolan*, 668 P.2d 916 (Colo. 1983) 27

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NCR Corp. v. *Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989) 27

NCR Corp. v. *Comptroller*, 313 Md. 118, 544 A.2d 764 (Md. 1988) 27

NCR Corp. v. *South Carolina*, 402 S.E.2d 666 (SC. 1991) 27

Pledger v. *Illinois Tool Works, Inc.*, 306 Ark. 134, 812 S.W.2d 101 (Ark. 1991), *cert. denied*, ___ U.S. ___, 112 S. Ct. 418 (1991) 27

Shell Oil Company v. *Iowa Department of Revenue*, 488 U.S. 19 (1988) 13, 14

Tambrands, Inc. v. *State Tax Assessor*, 595 A.2d 1039, ___ N.E.2d ___ (Me. 1991) 27

Trinova Corp. v. *Michigan Treasury Dept.*, 498 U.S. ___, 111 S. Ct. 818 (1991) 24

Williams Companies v. *Director of Revenue*, 799 S.W.2d 602 (Mo. 1990) 27

STATUTES:

26 U.S.C. § 316 18

Internal Revenue Code § 316 18

Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985) . . . . . *passim*

§ 1(a) 10, 19

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INTEREST OF AMICI CURIAE

Amici are states which compute the individual tax liabilities of multijurisdictional taxpayers under the "unitary business principle" pursuant to the Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985), hereinafter the Uniform Act. Under the provisions of the Uniform Act, income is divided between

"business income" which is subject to apportionment among the various states and "nonbusiness income" which is typically allocated or assigned to a single state.

New Jersey has not adopted the Uniform Act and its statute on its face does not distinguish between income which is apportionable and that which is specifically assigned to a particular state.[1] Nonetheless, amici share with New Jersey a common concern as to the limits upon State income taxation which arise from the Due Process and Commerce Clauses of the Constitution. In particular, amici are concerned with the standards for determining when income arising from the ownership of intangible property can be subjected to apportionment under the Due Process and Commerce Clauses of the Constitution and whether the Uniform Act meets those standards.

Amici have a particular interest in the clarification of the proper application of this Court's decision in *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and specifically whether or not it is necessary to establish that there is a "unitary business" relationship between the holder and the issuer of the intangible.[2] One, but not the only, way

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[1] Unlike the Uniform Act, New Jersey's statute does not distinguish between "business income" and "nonbusiness income." Under the New Jersey statute, all income is apportionable subject to the constraints of the Due Process Clause. Those constraints are similar to the considerations underlying the classification of income as "business income" because income cannot constitutionally be apportioned unless it arises from the activities of a unitary business.

[2] Confusion with respect to this question arose in part because of analytical concessions which this Court viewed Idaho as making and, in larger part, because the case as originally considered by the Idaho Supreme Court, *American Smelting & Refining Co.* v. *Idaho State Tax Com.*, 102 Idaho 38, 624 P.2d 946 (1981), was a "combined report" case involving

(continued...)

to establish the apportionability of the income arising from an intangible is if the holder and issuer of the intangible are in a "unitary business." More fundamentally, however, apportionability is established through the relationship between the intangible and the business of its owner. Amici have a direct interest in the clarification of this question which is involved in this case. A resolution of this issue involves hundreds of millions of dollars in state taxes annually.

STATEMENT PURSUANT TO RULE 37

This brief is submitted pursuant to Rule 37.3 of this Court in support of Respondent, the Director, Division of Taxation, State of New Jersey. Consent to the filing of this brief has not been requested from the parties because the amici filing this brief are the Attorneys General of their respective States. Rule 37.5 U.S. Sup. Ct.

SUMMARY OF ARGUMENT

This is another case involving the "unitary business principle." Unlike most "unitary business principle" cases reviewed by this Court, there is no question as to the fairness

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[2](...continued)
the question of whether various wholly owned subsidiaries were engaged in a "unitary business" with the parent. The question of the "business income" characterization of the dividends received from the affiliates was an ancillary question. Nonetheless, the "combined report" aspects of the case clearly became intertwined with the "business income" question. As explained in this brief, "combined reporting" is a "scope of the unitary business" analysis, and "business income" characterization is a type of tracing analysis which is applied after the scope of the unitary business is determined.

of the New Jersey apportionment method, no claim, or even suggestion, that the income attributed to New Jersey is out of all appropriate proportion to the business conducted in New Jersey, no claims of discrimination and none of multiple taxation. Petitioner claims only that New Jersey could not include this income in its apportionable base because it, the petitioner, and the entity in which it held a twenty percent stock interest were not engaged in a unitary business. This Court is now presented with the precise question which the parties conceded in *Mobil Oil Corporation* v. *Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *ASARCO*, 458 U.S. 307 (1982) and *F.W. Woolworth Co.* v. *Taxation and Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982)—whether the classification of an item of income arising from an intangible as "business income," that is, "apportionable" income, requires a "unitary" relationship between the holder of the intangible and the issuer of the intangible.

The Uniform Act effectively tracks this Court's Due Process and Commerce Clauses analysis and, therefore, the New Jersey assessment here at issue can properly be analyzed under the Uniform Act in spite of the fact that New Jersey has not adopted it. Under the Uniform Act, the classification of income as "business income," or income subject to apportionment, is made by reference to the activities of the taxpayer or the unitary business. If the holder and issuer of the intangible are in a unitary business relationship, income from the intangible is invariably "business income." This is not, however, the only relationship which justifies "business income" classification. Many circumstances (see examples, *infra*, pp. 16-17) give rise to "business income" without the

necessity of a unitary relationship between the recipient and payor.

This Court's analysis in *ASARCO*, 458 U.S. 307; *Woolworth*, 458 U.S. 354 and *Mobil*, 445 U.S. 425, to the extent it focuses on the relationship between the payor and payee of dividends as solely determinative of the question of apportionability, was flawed and should not be applied in this case. The flaw in this analysis is graphically demonstrated in this case where the item of income involved is a capital gain. The issuer of the stock which was sold for a capital gain will never pay tax on the gain because it is never economically, or for tax purposes, viewed as the issuer's income. Such gain is only the income of the holder of the stock and it is only its activities which give rise to the gain or in any way relate to it. Amici request this Court to clarify the application of the "unitary business principle" to income arising from intangibles which are an integral part of a taxpayer's "unitary business" so that State courts can effectively and properly address this issue.

Petitioner is asking this Court to reverse a determination of the New Jersey courts, supported by an evidentiary record, that income arising from the disposition of a stock interest in another corporation was properly included in the income base which New Jersey subjected to apportionment. It is the petitioner which bears the burden of showing that the gain here at issue is unrelated to the unitary business, a part of which is carried on in New Jersey. It has failed to meet this burden.

Sustaining the New Jersey assessments in this case will not trivialize the "unitary business principle" and will not give rise to abusive taxation by the States. Petitioner has not

claimed it will be subjected to multiple tax burdens[3] and, therefore, is not seeking to avoid multiple taxation, but rather is asking this Court to provide it and other multijurisdictional taxpayers with an unwarranted shield from State taxation of income arising from intangibles which are part of its "unitary business."

The action of the New Jersey courts should be sustained.

ARGUMENT

I

INTRODUCTION

This case involves the review of a state income tax assessment under the "unitary business principle." The specific question presented is whether income received by a nondomiciliary taxpayer arising from the ownership of an intangible may be included in the income subject to apportionment by the taxing state. In *Mobil*, 445 U.S. 425, this Court stated "the linchpin of apportionability in the field of state income taxation is the unitary business principle." *Mobil*, 445 U.S. at 439. Proper analysis of the arguments submitted in support of and in opposition to the tax at issue requires a delineation of what is involved in the "unitary business principle."

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[3] The significance of this concession is that this is not a case where the State of commercial domicile, in this case Michigan, is taxing 100 percent of the income; therefore, no multiple taxation dispute exists.

The "unitary business principle" is a product of this Court's analysis of the constraints placed upon State taxation by the Due Process and Commerce Clauses of the Constitution. As described by this Court in *Container Corporation of America* v. *Franchise Tax Board*, 463 U.S. 159 (1983), the "unitary business principle":

> "first defin[es] the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportion[s] the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." 463 U.S. at 165.[4]

There are three parts to the Court's description: (1) the scope of the unitary business (what activities constitute the unitary

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[4] The Court in *Container* continues by stating that "Two aspects of the unitary business/formula apportionment method have traditionally attracted judicial attention. These are, as one might easily guess, the notions of 'unitary business' and 'formula apportionment,' respectively." 463 U.S. at 165. This does not, of course, indicate that these are the only two elements or questions involved in a "unitary business" analysis. To the extent the Court's decisions in *Mobil*, 445 U.S. 425; *ASARCO*, 458 U.S. 307 and *F. W. Woolworth*, 458 U.S. 354, are to be considered to fall within the first class, amici submit it is only because of the concessions of the litigants and the analysis applied in those cases, not because of their true nature. See *infra*, pp. 14-21.

business), (2) the income arising from such activities, and (3) the apportionment formula.[5]

The focus of the Court's inquiry into the scope of the "unitary business" is upon activities. The question of whether a state can consider income arising out of extraterritorial activities is determined by whether there is "a 'minimal connection' or 'nexus' between the interstate activities and the taxing state." *Exxon Corporation* v. *Wisconsin Department of Revenue*, 447 U.S. 207 at 219 (1980) (emphasis added). "[T]he principles we have quoted [Due Process and Commerce Clause] require that the out-of-state activities of the purported 'unitary business' be related in some concrete way to the in-state activities." *Container*, 463 U.S. at 166 (emphasis added).

The scope of the "unitary business" can, as it is by New Jersey, be determined by reference to the activities of a single corporate entity (see, e.g., *Exxon*, 447 U.S. 207) or by reference to a group of commonly owned and controlled entities as it is in a combined report jurisdiction (see, e.g., *Container*, 463 U.S. 159). As this Court pointed out in *Container*, "there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." 463 U.S. at 167.

Once the scope of the "unitary business" has been established, the second inquiry focuses on whether the income arises out of interstate activities. It has long been settled that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned . . . [citations omitted]." *Exxon*, 447 U.S. at 219. To be

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[5] The parties are in agreement that there are no questions concerning the application of the apportionment formula in this case.

considered in the tax base, or to be taxed, the item of income must be the taxpayer's. The activities to be considered in determining whether the income is apportionable are the activities of the taxpayer and, more particularly, the activities of the unitary business, a part of which is conducted in the taxing state. If the income arises from activities which are not part of such a unitary business, then there is no concrete connection which authorizes the State to consider the item of income in determining its tax.

In the *Container* case, the Court pointed out that the Uniform Act is one of the forms which the unitary business/formula apportionment method has taken and that it is used by a significant number of the States. 463 U.S. at 165. Specifically, the Court noted that the

> "Uniform Act . . . track[s] in large part the principles [Due Process and Commerce Clause] we have just discussed. In particular, the statute distinguishes between the 'business income' of a multijurisdictional enterprise, which is apportioned by formula, [citations to the California Statutes], and its 'nonbusiness' income, which is not. Although the statute does not explicitly require that income from distinct business enterprises be apportioned separately, this requirement antedated adoption of the Uniform Act, and has not been abandoned." (Footnotes omitted.) 463 U.S. at 167 (emphasis added).

Based upon this Court's statement that the Uniform Act, and in particular California's application of the Uniform

Act, to a large extent "tracks" its analysis and application of the Due Process and Commerce Clause constraints which have given rise to the "unitary business principle," amici will analyze this case under the provisions of the Uniform Act. Amici will use the term "business income" as meaning income subject to apportionment, that is, as income which under this Court's analysis may be considered by the taxing state.[6]

II

THE DETERMINATION OF WHETHER INCOME IS BUSINESS INCOME, OR APPORTIONABLE, IS MADE SOLELY BY REFERENCE TO THE RELATIONSHIP OF THE ITEM OF INCOME TO THE TAXPAYER'S ACTIVITIES

The Uniform Act defines "business income" as:

> "[I]ncome arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." Section 1(a).

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[6] Under Section 9 of the Uniform Act, all business income is subject to apportionment. "The linchpin of apportionability . . . is the unitary business principle." *Mobil*, 445 U.S. at 439. Ergo, business income arises from the unitary business.

The definition establishes the "business income" relationship by reference to the "taxpayer's trade or business."[7] There is no reference to the trade or business of anyone else.

The definition is applicable regardless of whether the income arises from "tangible" or "intangible" property. No different test is set forth based on the nature of the property. It is not the nature of the property involved but the relationship of the item of income to the taxpayer's activities which controls. The definition of "business income" does not turn upon the type of income involved. There is no reference in the definition to dividends, capital gains, interest, royalties, operating income or any other type of income. Again, the "business income" characterization is based upon the relationship of the item of income to the taxpayer's activities.

The definition also states that "business income" can arise from the property itself and from the "acquisition, management, and disposition" of the property. The only requirement is that the acquisition, management and disposition of the property be part of the taxpayer's regular (unitary) trade or business. Because of this, California, and many other states which have enacted the Uniform Act, view the definition of "business income" to contemplate two separate but complementary tests—a transactional test and a functional test. The satisfaction of either one of these tests results in the classification of a particular item of income as

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[7] In a "combined report" state such as California, for purposes of determining the scope of the unitary business, the business or nonbusiness character of income and the apportionment formula, the term "taxpayer" includes all commonly owned and controlled entities. In the case of New Jersey and other states, it involves a single entity. The analytical principles are similar, however.

"business income," or income which is subject to apportionment.

The transactional test is satisfied when the income arises from a transaction or activity in the regular course of a taxpayer's trade or business. Classic examples of transactional "business income" include the sale by a manufacturing company of the product which it manufactures, the sale of crude oil or refined product by an oil company, and the sale of merchandise by a retailer. The transactional nature of an item of income is determined by reference to the business of the taxpayer. Therefore, a bank realizes "business income" from its return on the investment of customer deposits whether it arises from interest on loans, credit card fees or the holding of government securities.

The "functional" test is satisfied when the income arises from the "acquisition, management and disposition" of an asset which is held as part of or in the course of the unitary business. This test is necessary to deal with the "unusual" event. An example is a manufacturing company that constructs a new plant and sells an old plant. It is not in the regular business of buying and selling plants, but the plant is necessary to the operation of its business. Under the functional test, the proceeds on the disposal of the plant constitute "business income" even though the disposition of the plant did not occur as a routine, periodic part of the regular business activity. Use of the "functional" standard requires that consideration be given to the relationship between a taxpayer's property, tangible or intangible, and the taxpayer's business operations in order to determine whether the income arising therefrom is "business income." If the taxpayer is engaged in a unitary business, then the inquiry into its "business" necessarily involves inquiry into its "unitary

business." This consideration is necessitated by the Due Process requirement of a minimal connection between the item of income and the activities in the state. In the case of intangibles, if the property which gives rise to the income is integrally related to the unitary business activities of the taxpayer, it is "business income." If part of the activities of the unitary business take place in a non-domiciliary state, then the "business income" of the taxpayer, including income from intangibles, is subject to apportionment by that state.

An item of income may satisfy both the transactional and functional tests. An example of such "business income" is the interest arising from the short-term investment of working capital. The taxpayer, unless it is a bank or similar entity, is not in the business of investing money, but it is in the business of regularly and routinely obtaining a return on its idle assets pending their use in the unitary business. Frequently, such funds are invested in short-term securities.[8] This interest is routinely classified as "business income" by both taxpayer and tax administrator, and properly so.[9]

In the course of the last decade and a half, this Court has given extensive consideration to the "unitary business principle" as it affects state income taxation. The principal decisions of this Court which consider the question of what constitutes a unitary business and what is "business income" are *Mobil*, 445 U.S. 425; *Exxon*, 447 U.S. 207; *ASARCO*, 458 U.S. 307; *Woolworth*, 458 U.S. 354; *Container*, 463 U.S. 159; *Shell Oil Company* v. *Iowa Department of Revenue*,

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[8] The taxpayer has no concern with whether it realizes income as interest, dividends or gains. It seeks the maximum return, commensurate with safety, over the period of investment.

[9] See, e.g., JA p. 13; *American Home Products Corp.* v. *Limbach*, 49 Ohio St. 3d 158, 551 N.E.2d 201 (Oh. 1990).

488 U.S. 19 (1988); and *Amerada Hess Corp.* v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989).

Exxon (divisions of a single corporation) and *Container* (parent and subsidiaries) directly involved the scope of the unitary business. Those cases were correctly analyzed and decided on that basis. In both cases, the question presented to the Court was whether or not activities taking place outside of the taxing jurisdiction could be considered in determining the income apportionable to the state.

Amerada Hess and *Shell* were "business income" cases, where the question presented was whether a particular expense or receipt of the unitary business, a "windfall profits" tax and Outer-Continental Shelf income, respectively, could be separated when they did not directly arise from the activities in the taxing state. The Court stated in *Amerada Hess*:

> "Appellants, however, underestimate the fact that, for apportionment purposes, it is inappropriate to consider the windfall profit tax as an out-of-state expense. Rather, just as each appellant's oil-producing revenue—as part of a unitary business—is not confined to a single State [citations omitted], so too the costs of producing this revenue are unitary in nature." 490 U.S. at 74.

Mobil, *ASARCO* and *Woolworth* are also "business income" cases. Each of these cases considered the question of whether dividends received by a nondomiciliary taxpayer could be included in apportionable or "business income." However, these cases were analyzed as if they involved the scope of the unitary business, that is, whether the activities

conducted by the payors of the dividends in those cases were part of the unitary business conducted by the recipient of the dividend payment. This analytical framework arose as a result of "concessions" made by the losing party.[10]

This Court's focus on the scope of the unitary business to the exclusion of the consideration of whether the items of income at issue arose from activities of the unitary business was analytically flawed. *Mobil* was correctly decided and its result was unaffected by application of the flawed analysis because one of several ways to establish that dividends are

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[10] In the *Mobil* decision, the Court, after commenting on the lack of evidence in the record, noted:

> "many of these subsidiaries and affiliates [the dividend payors], including the principal contributors to appellant's dividend income, engage in business activities that form part of Mobil's integrated petroleum enterprise. Indeed, although appellant is unwilling to concede the legal conclusion that these activities form part of a 'unitary business'. . . it has offered no evidence that would undermine the conclusion that most, if not all, of its subsidiaries and affiliates contribute to appellant's worldwide petroleum enterprise." 445 U.S. at 435.

In *ASARCO*, the Court stated "Neither does it [Idaho] question that a unitary business relationship between ASARCO and these subsidiaries [the dividend payors] is a necessary prerequisite to its taxation of the dividends at issue." 458 U.S. at 325. It should also be noted that in the Idaho Supreme Court, the primary issue was the combined reporting treatment applied to the unitary subsidiaries. The treatment of the dividends was only an ancillary issue. *American Smelting & Refining*, 624 P.2d 946 (1981).

In *Woolworth*, the Court reviewed the New Mexico Supreme Court's analysis of whether a unitary business relationship between payor and payee was necessary and found that the application of this analysis (whether the payor and payees were unitary) by the New Mexico Supreme Court was flawed without considering whether the species of analysis applied was the proper one. 458 U.S. at 360.

"business income" is to show that the payor and payee are part of the same unitary business and because Mobil did not focus on its minority shareholder status and, therefore, its inability to control the dividend payor. In *ASARCO* and *Woolworth*, however, application of the flawed analytical framework precluded the States from being able to sustain their assessments and led to an erroneous conclusion by the Court.[11]

Consideration of several examples illustrates the point that a unitary relationship between the payor and payee is not necessary for finding an item to be "business income":

> Example 1: A manufacturing business sells its product to an unrelated third party. The transaction gives rise to "business income."
>
> Example 2: A bank lends money to an unrelated third party and receives interest as a result. The interest is "business income."
>
> Example 3: An investment company receives dividends from the investment of its capital in a 10-percent interest in each of three unrelated companies. The dividends are "business income."
>
> Example 4: A department store purchases the corporate securities of a third party with the

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[11] For an excellent discussion of the analytical problems presented, see "The Supreme Court 1981 Term," 96 *Harv.L.Rev.* 62, in particular pp. 93-96.

proceeds from its sale of merchandise to third parties at Christmas. The obligations are sold prior to the next Christmas to replenish inventories. The interest, dividends or capital gains realized are "business income."

Example 5: A drug company develops and patents a new drug. It manufactures and sells the drug in the United States and also licenses unrelated third parties to manufacture and sell the drug world wide. The proceeds from its own sale of the drug and the license fees received are all "business income."

Example 6: A petroleum company purchases a substantial minority interest in a corporation operating an oil concession to obtain an assured source of crude oil. Proceeds from the purchase and resale of the crude and the dividends received from the ownership of the minority stock interest are "business income."

In none of these examples is the recipient of the payment in a unitary business relationship with the maker of the payment, yet virtually all state tax administrators and taxpayers would agree that all of the receipts were "business income" within the meaning of the Uniform Act and thus apportionable among the parts of the taxpayer's unitary business.

The "requirement" that there be a unitary business relationship between the payor and payee arose in cases

involving the classification of dividend income.[12] An examination of the treatment of capital gains, however, illustrates the fallacy of the requirement of a payor/payee unitary relationship. This is not to say that dividends and capital gains require a different analysis or that a different result is required depending on the type or receipt. To the contrary, what it establishes is that the analytical framework used for the dividends in *ASARCO* was faulty because it is inapplicable to capital gains.

With respect to dividends, it is possible to argue that the income arises from the activity of the payor because there would be no dividends if the payor had no earnings.[13] If the payor had earnings, then it has been, or at least could have been, taxed on those earnings when they arose.[14] In the case of capital gains arising from the ownership of stock, however, the issuer of the stock has no earnings when the stock is

---

[12] Only in *ASARCO* was any question raised as to the classification of other types of receipts from intangibles. In *ASARCO*, the proper classification of capital gains realized on the sale of the stock of one of the dividend-paying subsidiaries and interest received as the result of the sale of another of the subsidiaries was ostensibly at issue. But as the Court noted, "Idaho and ASARCO agree that interest and capital gains income derived from these companies should be treated in the same manner as the dividend income." 458 U.S. at 329. The Court indicated its agreement in four brief sentences.

[13] In a tax sense, dividends can only arise if the statutory requirements of either accumulated earnings or profits or current year's earnings or profits are met. See, e.g., § 316 Internal Revenue Code, 26 U.S.C. § 316.

[14] It should also be noted, however, that it is the earning of income which is taxed to the payor. The payment from that income of dividends is not a taxable event to the payor; it is only a taxable event to the payee. This illustrates the mischief which can arise if activities outside of the unitary business are considered in determining whether an item of income is "business income" to the recipient. It is this analytical flaw which appears to explain the dissent filed in *Mobil*, 445 U.S. at 449-462.

bought and sold by the third parties. The gains realized, or losses sustained, may reflect the outside world's view of the results of the issuer's activities, or they may have no relationship whatsoever. But the point to be made is that the third-party seller is the only entity which has income, in both a taxable and economic sense, and therefore is the only entity which can be assessed a tax on those results. In the case of capital gains, as contrasted to dividends, there is neither a technical, nor economic, argument which superficially supports consideration of the activities of the issuer of the stock in apportioning the income. It is only the activities of the holder of the stock which should, and which need to, be considered.[15]

The Uniform Act characterizes income as "business income" or "nonbusiness income." It defines "business income." Section 1(a). "Nonbusiness income" is "all income other than business income." Section 1(e). The presence of the two terms makes it clear that a taxpayer may have both types of income, and the exclusionary nature of the nonbusiness definition makes it clear that there are no other types of income.

Under the Uniform Act, the determination of whether income is "business" or "nonbusiness" is made by reference to the activities of the taxpayer. It is the corporation which establishes what the business of the corporation is, determines whether an activity is in the course of the regular business of the corporation, and determines whether a particular item of property is acquired, managed and disposed of as part of the

---

[15] The point is also made in the case of interest and royalties. Not only does the payor not have income, but, in fact, it receives a deduction.

regular business. This Court, consistent with the Uniform Act, recognized that not all income is "business income" or income subject to apportionment. It properly held in *Woolworth* that a standard which treated all income as business income

> "would trivialize this due process limitation by holding it satisfied if the income in question 'adds to the riches of the corporation. . . .' [Citations omitted.] Income, from whatever source, always is a 'business advantage' to a corporation. Our cases demand more." 458 U.S. at 363.

This Court in *ASARCO* rejected too hastily "corporate purpose" as the test. 458 U.S. at 326-329. "Corporate purpose," correctly defined, is the proper standard for determining apportionability. "Corporate purpose" has meaning in the context of the Uniform Act when it is understood as being controlled by the purpose for which the corporation holds the asset.[16] If the taxpayer holds itself out as actively engaged in acquiring, managing and disposing of intangibles as part of its operational business strategy and in furtherance of its operating business, then a state can, consistent with the requirements of Due Process analysis, conclude that it is generating "business income" from such activities. Passive investments do not give rise to "business income." "Purpose" is not just having a profit motive, but

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[16] Perhaps the term "unitary purpose" or "business purpose" more accurately captures the Uniform Act distinction between "business" and "nonbusiness" income.

instead is defined by the "unitary business" of the taxpayer. This definition is consistent with the Uniform Act. Petitioner decries this as a "unitary business doctrine defined largely by corporate rhetoric." (Appellant's Opening Brief, hereinafter AOB, p. 35.) But what is wrong with a State relying upon an admission by a taxpayer in determining its tax if it chooses to do so?

III

THE PETITIONER HAS NOT ESTABLISHED THAT THE CAPITAL GAINS HERE AT ISSUE AROSE FROM A DISCRETE BUSINESS ENTERPRISE CONDUCTED BY PETITIONER

This Court has stated on numerous occasions and reaffirmed in *Container*, which was decided subsequent to *ASARCO* and *Woolworth*, that:

> "the taxpayer always has the 'distinct burden of showing by "clear and cogent evidence" that [the state tax] results in extraterritorial values being taxed.' [Citation omitted; insertion by the Court.] One necessary corollary of that principle is that this Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a 'unitary business.' As we said in a closely related context in *Norton Co.* v. *Department of Revenue* [citation omitted]:

> 'The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption.
>
> 'This burden is never met merely by showing a fair difference of opinion which as an original matter might be decided differently . . . . Of course, in constitutional cases, we have power to examine the whole record to arrive at an independent judgment as to whether constitutional rights have been invaded, but that does not mean that we will re-examine, as a court of first instance, findings of fact supported by substantial evidence.' [Citations omitted.] (footnotes omitted; emphasis added)." 463 U.S. at 175-176.

This is the burden which the petitioner must carry in this case. If the judgment of the New Jersey courts is supported by substantial evidence, then this Court should sustain their findings in spite of the fact that a different result could be reached.

In *Mobil*, 445 U.S.at 435, and *Woolworth*, 458 U.S. at 360, this Court commented on the scanty evidence in the record. Amici, based upon their review as non-parties, do not believe the record in this case can be so characterized. There is substantial evidence which supports the conclusion of the New Jersey courts that the capital gains did not arise in the

course of a discrete business enterprise conducted by the taxpayer.[17]

Not only has the petitioner failed to carry its burden, but New Jersey has affirmatively established the required linkage. Review of the factual record in this case shows that the petitioner treated its activities regarding ASARCO as a discrete business in one instance and for a single purpose—-to exclude the capital gain it realized on the sale of its interest from the income subject to apportionment by New Jersey. In all other aspects, the petitioner treated its activities regarding ASARCO, and the income and expense arising therefrom, as part of its single unitary business, a portion of which was conducted in New Jersey. These other aspects include the following:

- Bendix did not file on a lines-of-business approach in New Jersey in spite of the fact that only two of its four lines of business were present in New Jersey. (Stip. ¶11, Joint Appendix, hereinafter JA, pp. 154-155; Stip. ¶¶31-38a, JA pp. 161-163.)

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[17] Amici note that the parties have stipulated that ASARCO and the petitioner are not in a unitary business. As explained in the preceding section, that is not determinative of the outcome of this case. The relevant inquiry is whether petitioner has shown by "clear and cogent" evidence that the capital gains which arose as a result of the petitioner's activity have been shown to be unrelated to the activities of petitioner's unitary business, a part of which the petitioner carries on in New Jersey.

- Bendix did not remove the value of the ASARCO stock from its calculation of net worth which was also subject to an apportioned New Jersey tax.[18] (Stip. ¶4, JA p. 153.)

- Bendix borrowed money, over $100 million, to purchase the ASARCO stock and there is no evidence that it did not deduct the interest expense associated with this borrowing from its unitary income otherwise subject to New Jersey's apportionment. (Stip. ¶52, JA p. 167.)

- Bendix received dividends from its interest in ASARCO which it no longer contends should not be included in the income subject to apportionment. (JA p. 13.)

- There is no evidence that Bendix allocated any of its corporate overhead, including the salaries of William Agee and the Corporate Acquisition group, as separate from the base subject to New Jersey's apportioned tax.

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[18] The "unitary business principle" and apportionability do not apply only in the income tax setting. The principle first arose in property taxation, and in this last term was applied to the Michigan Single Business Tax. *Trinova Corp.* v. *Michigan Treasury Dept.*, 498 U.S. ___, 111 S. Ct. 818 (1991).

- There is no evidence that Bendix reported the capital gain as other than a part of the apportioned base for purposes of the taxes asserted by the State of Michigan, its commercial domicile, or assigned the capital gain on any basis, other than an apportioned basis, to any other state.

- Bendix no longer contests that all other capital gains and losses were apportionable income. (JA p. 13 & Petition for Certiorari.)

- Bendix no longer contests that the income arising from the investment of the proceeds of the sale of its interest in ASARCO gave rise to apportionable income. (JA p. 13.)

Each of these items goes to show that the Uniform Act definition of "business income" is met and therefore the income is classifiable as "business income." The sale of the ASARCO stock, given the other business activities entered into by the petitioner (see Stip. ¶¶128-157, JA pp. 183-192), was a transaction in the regular course of the petitioner's trade or business. The "acquisition, management and disposition" of the stock interest was an integral part of the petitioner's business.

Each of these items provides support for the determination of the New Jersey courts that this income can

be considered in the apportionable base and should cause this Court to sustain their determination.

IV

THIS COURT NEEDS TO CLARIFY THE CONFUSION CREATED BY ITS DECISION IN *ASARCO*

Amici agree with the petitioner that this Court should clarify its decision in *ASARCO*. (AOB Questions Presented 2., p. i). It is unlikely that amici and the petitioner would agree with the direction this clarification should take. Amici certainly disagree with the petitioner's contention that an affirmation of the lower court's decision would lead to egregious results.

ASARCO and *Woolworth* have been the subject of substantial unfavorable comment by scholars in the field of state taxation.[19] But what is of more importance, these decisions and the analysis of *Mobil* and the dissent therein

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[19] Walter Hellerstein, "State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication." 41 *Tax Lawyer* 37 (1988); Nancy A. Kelley, "The Unitary Tax Method: Are the Factors Used by California in the Determination of Unity Still Viable after *ASARCO* and *Woolworth*?" 15 *Pacific Law Journal* 109 (1983); Joel M. Greene, "*Asarco* and *Woolworth*: Anomalous Anachronisms with Limited Precedential Value," 18 Tax Notes No. 10 at 795 (March 7, 1983); Walter Hellerstein, "State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on *ASARCO* and *Woolworth*," 81 *Michigan Law Review* 157 (1982); Richard A. Hanson, "*ASARCO* and *Woolworth*—Refining *Mobil* and the 'Unitary Business' Test for Apportioning Intangible Income," 1 *Journal of State Taxation* 197 (1982); C. Douglas Floyd, "The 'Unitary' Business in State Taxation: Confusion at the Supreme Court?" 1982 *Brigham Young University Law Review* 465.

have led the state courts down a variety of paths including blind adherence[20], neglect[21], distinction[22], tortured avoidance[23], and well reasoned dissents[24]. The difficulty the states are having with this issue is reflected in recent petitions filed with this Court.[25]

This area of tangled jurisprudence can be clarified by recognition of the fact that two separate analytical frameworks are required in determining the scope of the unitary business and whether a particular income item results from operation of the unitary business.

Dividends received from a subsidiary or affiliate which is within the scope of the unitary business clearly can

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[20] *Corning Glass Works, Inc.* v. *Virginia Department of Taxation*, 241 Va. 353, 402 S.E.2d 35 (Va. 1991); *Pledger* v. *Illinois Tool Works, Inc.*, 306 Ark. 134, 812 S.W.2d 101 (Ark. 1991); *Brunner Enter., Inc.* v. *Department of Revenue*, 452 So.2d 550 (Fla. 1984).

[21] *Lone Star Steel Co.* v. *Dolan*, 668 P.2d 916 (Colo. 1983).

[22] *NCR Corp.* v. *Comptroller*, 313 Md. 118, 544 A.2d 764 (Md. 1988); *NCR Corp.* v. *South Carolina*, 402 S.E.2d 666 (SC. 1991); *NCR Corp.* v. *Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1988); and *Williams Companies* v. *Director of Revenue*, 799 S.W.2d 602 (Mo. 1990).

[23] *American Home Products Corp.* v. *Limbach*, 49 Ohio St. 3rd 158, 551 N.E.2d 201 (Oh. 1990); *American Telephone & Telegraph* v. *Wisconsin Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629 (Wis. 1988).

[24] *Pledger* v. *Illinois Tools*, 306 Ark. 134, 812 S.W.2d 101 (Ark. 1991); *Tambrands, Inc.* v. *State Tax Assessor*, 595 A.2d 1039, ___ N.E.2d ___ (Me. 1991); *NCR Corp.* v. *South Carolina*, 402 S.E.2d 666 (SC 1991); *Williams Companies* v. *Director of Revenue*, 799 S.W.2d 602 (Mo. 1990); *Dow Chemical Company* v. *Director of Revenue*, 787 S.W.2d 276 (Mo. 1990).

[25] *Pledger* v. *Illinois Tool Works, Inc., cert. denied*, ___ U.S. ___, 112 S. Ct. 418 (1991); *Corning Glass Works, Inc.* v. *Virginia Dep't of Taxation, cert. denied*, ___ U.S. ___, 112 S. Ct. 277 (1991).

constitutionally be treated as "business income."[26] But Amici respectfully submit that this is not the only basis upon which dividends and other income from intangibles can give rise to "business income." The key relationship or link which must be made is between the acquisition, management and disposition of the income-producing intangible which produces the item of income and the activities of the unitary business. Recognition and acceptance of this principle by this Court will clear the tangled brush. The petitioner argues against this result on the basis of the doctrine of stare decisis (AOB p. 41) but provides no analytical support. This lack of analysis characterizes the lack of vitality of petitioner's entire attack on New Jersey's assessment.

Petitioner decries what it sees as the consequences of this Court sustaining New Jersey's determination, the apportioned consideration of income from intangibles in the tax base of all states. (AOB Argument E, pp. 40-42). What is wrong with this result? A possible consequence in some cases, but not here, might be multiple taxation, in full by the state of domicile and on an apportioned basis by all other states, but only if the Court were not prepared to adjudicate the issue. Petitioner is not concerned about multiple taxation, as shown by its failure to raise that issue in this case, but rather with the loss of its ability to shield significant portions of its income from state taxation.

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[26] If the requisite ownership and control is present, California would "combine" the two corporate entities and compute the California tax of each by reference to a "combined report"; under these circumstances, California would not include in unitary net income any dividends passed within the unitary group of corporations. This Court has recognized that such variations are permissible. *Container*, 463 U.S. at 167.

CONCLUSION

The Court should clarify the analytical framework of the "unitary business principle." The question of the scope of a unitary business is a different inquiry from the determination of whether an item of income arises from the activities of the unitary business once that scope is determined. In *Container*, this Court took a step back from its decisions in *ASARCO* and *Woolworth* and reaffirmed its earlier precedents concerning the evidentiary duties of taxpayers and tax administrators. Now the Court needs to step back from these decisions again in order to return reason to the analytical framework of the "unitary business principle." The circumstances of this case, wherein a state is seeking to apportion capital gain income by reference to the activities of the only entity which can ever be taxed on this income, crystallizes this difference in a way cases involving the taxation of dividends never can.

The petitioner in this case has refused to recognize and accept its burden of showing that the sale of its interest in ASARCO was unrelated to the business which it partly carried on in New Jersey. In contrast, even though the State does not bear the burden, New Jersey has shown that the petitioner

treated its interest in ASARCO as an integral part of its business. The action of New Jersey should be sustained.

Dated: February 7, 1992

Respectfully submitted,

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(13)

No. 91-615-CSX
Status: GRANTED

Title: Allied-Signal, Inc., as successor-in-interest to The Bendix Corporation, Petitioner
v.
Director, Division of Taxation

Docketed:
October 11, 1991

Court: Supreme Court of New Jersey

Counsel for petitioner: Willson Jr.,Prentiss

Counsel for respondent: Hamill,Mary R.

101191 Counsel states respond shld be as above & is out of NJ

Entry	Date	Note	Proceedings and Orders
1	Oct 11 1991	G	Petition for writ of certiorari filed.
2	Nov 13 1991		DISTRIBUTED. November 27, 1991
3	Nov 15 1991	X	Brief of respondent Director, Division of Taxes in opposition filed.
4	Nov 21 1991	X	Reply brief of petitioner Allied-Signal, Inc. filed.
5	Nov 27 1991		Petition GRANTED.
			**********
6	Jan 2 1992		SET FOR ARGUMENT WEDNESDAY, MARCH 4, 1992. (2ND CASE)
9	Jan 9 1992		Brief amicus curiae of Williams Companies, Inc. filed.
7	Jan 10 1992		Joint appendix filed.
8	Jan 10 1992		Brief of petitioner Allied-Signal, Inc. filed.
10	Jan 10 1992		Brief amicus curiae of Committee on State Taxation filed.
12	Jan 16 1992		Record filed.
		*	Certified record and proceedings Supreme Court of New Jersey (1 Box).
11	Jan 24 1992		CIRCULATED.
16	Feb 7 1992	X	Brief amici curiae of California, et al.(TO BE RECOVERED) filed.
13	Feb 10 1992	X	Brief of respondent Director, Division of Taxation filed.
14	Feb 10 1992	X	Brief amici curiae of Massachusetts, Connecticut, Maryland and Virginia filed.
15	Feb 10 1992	X	Brief amicus curiae of Multistate Tax Commission filed.
17	Feb 26 1992	X	Reply brief of petitioner Allied-Signal, Inc. filed.
18	Mar 4 1992		ARGUED.
19	Mar 11 1992		This case is restored to the calendar for reargument during the April Session. The parties are requested to simultaneously file with the Clerk of this Court and serve upon the parties, on or before 3 p.m., Friday, April 10, 1992, supplemental briefs addressing the following questions: 1. Should the Court overrule Asarco v. Idaho State Tax Commission, 458 U.S. 307 (1982), and F. W. Woolworth Co. v. Taxation & Revenue Department, 458 U. S. 354 (1982)? 2. If Asarco and Woolworth were overruled, should the decision apply retroactively? 3. If Asarco and Woolworth were overruled, what constitutional principles should govern state taxation of corporations doing business in several states? Replies thereto, if any, are to be filed with the Clerk and served upon the parties on or before noon, Friday,

2pp

No. 91-615-CSX

Entry	Date	Note	Proceedings and Orders
			April 17, 1992. The views of amici curiae are invited.
20	Mar 11 1992		SET FOR REARGUMENT WEDNESDAY, APRIL 22, 1992. (3RD CASE)
21	Mar 31 1992	D	Motion of the Attorney General of Commonwealth of Virginia for leave to participate in oral argument as amicus curiae, for divided argument and for additional time for oral argument filed.
22	Apr 6 1992		Motion of the Attorney General of Commonwealth of Virginia for leave to participate in oral argument as amicus curiae, for divided argument and for additional time for oral argument DENIED.
37	Apr 8 1992	X	Brief amici curiae of California, et al. filed.
31	Apr 9 1992	X	Brief amicus curiae of Georgia Coalition of Military Federal Retirees, Inc. filed.
34	Apr 9 1992	X	Brief amicus curiae of City of New York filed.
24	Apr 10 1992	X	Brief of petitioner Allied-Signal, Inc. filed.
25	Apr 10 1992	X	Brief amici curiae of American Home Products, et al. filed.
26	Apr 10 1992	X	Brief amicus curiae of American General Corporation filed.
27	Apr 10 1992	X	Brief amicus curiae of Committee on State Taxation filed.
28	Apr 10 1992	X	Brief amici curiae of Beatrice Company, et al. filed.
29	Apr 10 1992	X	Brief amicus curiae of Financial Institutions State Tax Coalition filed.
30	Apr 10 1992	X	Brief amici curiae of Amway Corporation, et al. filed.
32	Apr 10 1992	X	Brief of respondent Director, Division of Taxation filed.
33	Apr 10 1992	X	Brief amici curiae of Alabama, et al. filed.
35	Apr 10 1992	X	Brief amicus curiae of Chevron Corporation filed.
36	Apr 10 1992	X	Brief amici curiae of Connecticut, et al. filed.
38	Apr 10 1992	X	Brief amicus curiae of Multistate Tax Commission filed.
39	Apr 10 1992	X	Brief amici curiae of General Motors, et al. filed.
40	Apr 10 1992	X	Brief amicus curiae of Tax Executives Institute, Inc. filed.
43	Apr 16 1992	D	Motion of respondent to strike amicus curiae brief of General Motors Corporation, et al. filed.
44	Apr 16 1992		Opposition of General Motors Corporation, et al. to motion of respondent to strike amicus curiae brief of General filed.
41	Apr 17 1992	X	Reply brief of petitioner Allied-Signal, Inc. filed.
42	Apr 17 1992	X	Reply brief of respondent Dir., Div. of Taxation filed.
45	Apr 22 1992	G	Motion of respondent to strike amicus curiae brief of Georgia Coalition of Military Retirees, Inc. filed.
48	Apr 22 1992		ARGUED.
46	Apr 27 1992		Motion of respondent to strike amicus curiae brief of General Motors Corporation, et al. DENIED.
47	Apr 27 1992		Motion of respondent to strike amicus curiae brief of Georgia Coalition of Military Retirees, Inc. GRANTED.

(14)

No. 91-615

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation, PETITIONER

v.

DIRECTOR, DIVISION OF TAXATION, RESPONDENT

On Writ of Certiorari to the Supreme Court of New Jersey

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iv

INTRODUCTION 1

SUMMARY OF ARGUMENT 2

I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED BECAUSE THEY REFLECT SOUND AND DEEPLY ROOTED CONSTITUTIONAL RESTRAINTS ON STATE INCOME TAXATION OF MULTISTATE CORPORATIONS 5

A. The Unitary Business Principle, On Which *ASARCO* and *Woolworth* Squarely Rest, Embodies The Sound Constitutional Postulate That States May Not Tax Activities With Which They Have No Concrete Connection 6

B. The Specific Rule Governing *ASARCO* And *Woolworth*—That Investment Not Organically Related To The Taxpayer's Business Must Be Excluded From The Apportionable Tax Base—Comports With The Well-Reasoned Decisions Of This Court And The Disinterested Views Of Academic Commentators 10

C. The Existing Regime Of State Taxation Of Investment Income Should Not Be Disturbed Because It Provides A Settled, Workable, And Substantially Uniform Solution To Potentially Troublesome Division-Of-Income Problems 14

II. OVERRULING *ASARCO* AND *WOOLWORTH* WOULD DESTROY THE ESTABLISHED AND WORKABLE FRAMEWORK FOR DIVIDING CORPORATE INCOME AMONG THE STATES, AND ANY REPLACEMENT FOR THE PREVAILING CONSTITUTIONAL REGIME WOULD INCREASE COMPLEXITY, UNCERTAINTY, AND UNFAIRNESS 22

TABLE OF CONTENTS—Continued

Page

A. A Constitutional Regime Permitting States To Apportion All Of A Corporation's Intangible Investment Income Would Elevate Form Over Substance, Exacerbate Problems Of Fair Apportionment, And Render The Existing Taxing Schemes Of Most States Unconstitutional 23

1. *Form Versus Substance* 23

2. *Fair Apportionment* 25

3. *The Constitutional Condemnation of Existing State Tax Laws* 27

B. A Constitutional Regime Permitting States To Apportion All Of The Income Of A Corporation Operating In The State Regardless Of The Connection Of The Income Producing Activities To The State Would Create A System At War With Basic Notions Of Fairness And Common Sense And Would Require The Court To Assume A Much More Active Role In Reviewing State Tax Apportionments 30

1. *Misattribution of Income* 31

2. *Increased Judicial Monitoring of State Tax Apportionment* 33

C. If *ASARCO* and *Woolworth* Are Overruled, The Principles Governing State Taxation Of Multistate Corporations Should Be Designed To Assure Rationality In State Taxing Schemes, Avoid Duplicative Taxation, And Prevent Misattribution Of Income 34

III. CONSIDERATIONS OF *STARE DECISIS* STRONGLY FAVOR REAFFIRMATION OF *ASARCO* AND *WOOLWORTH* 34

TABLE OF CONTENTS—Continued

Page

IV. IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE DECISION SHOULD NOT BE RETROACTIVE 38

A. The Court Should Apply The *Chevron Oil* Test In Determining Whether New Principles Of Law Control The Case Before It 41

B. The *Chevron Oil* Test Would Preclude Retroactive Application Of A Decision Overruling *ASARCO* and *Woolworth* 45

CONCLUSION 48

APPENDIX 1a

TABLE OF AUTHORITIES

Cases	Page
Adams Express Co. v. Kentucky, 166 U.S. 171 (1898)	8, 11
Adams Express Co. v. Ohio, 165 U.S. 194 (1897)	8, 9, 10, 11
Alabama v. Smith, 490 U.S. 794 (1989)	36
American Express Co. v. Indiana, 165 U.S. 255 (1897)	8, 11
American Home Products Corp. v. Limbach, 49 Ohio St. 3d 158, 551 N.E.2d 201, *cert. denied*, 111 S. Ct. 63 (1990)	16, 18
American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266 (1987)	30
American Trucking Ass'ns, Inc. v. Smith, 110 S. Ct. 2323 (1990)	39, 40, 41, 42, 44, 47
Arizona Governing Committee v. Norris, 463 U.S. 1073 (1983)	47
Arizona v. Rumsey, 467 U.S. 203 (1984)	35
Arkansas Electric Cooperative Co. v. Arkansas Public Utility Comm'n, 461 U.S. 375 (1983)	36, 38
ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982)	*passim*
Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924)	9
Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932)	36
Butler Brothers v. McColgan, 315 U.S. 501 (1942)	9, 25
Central Railroad Co. of Pennsylvania v. Pennsylvania, 370 U.S. 607 (1962)	28
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)	39, 41, 42, 45, 46
Cipriano v. City of Houma, 395 U.S. 701 (1969)	41, 42
Collins v. Youngblood, 110 S. Ct. 2715 (1990)	36
Container Corporation of America v. Franchise Tax Bd., 463 U.S. 159 (1983)	*passim*
Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980)	29, 33
F.W. Woolworth Co. v. Taxation & Revenue Department, 458 U.S. 354 (1982)	*passim*

TABLE OF AUTHORITIES—Continued

Page

Fargo v. Hart, 193 U.S. 490 (1904) 11, 12, 18
First Bank Stock Corp. v. Minnesota, 301 U.S. 234 (1936) 16
Flood v. Kuhn, 407 U.S. 258 (1972) 43
Florida v. Long, 487 U.S. 223 (1988) 46
Government of Guam v. Federal Maritime Comm'n, 365 F.2d 515 (D.C. Cir. 1966) 18
Great Northern Ry. v. Sunburst Oil & Refining Co., 287 U.S. 358 (1932) 43, 44
Griffith v. Kentucky, 479 U.S. 314 (1987) 40
Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931) 9
Healy v. Beer Institute, Inc., 491 U.S. 324 (1989) .. 36
Heckler v. Mathews, 465 U.S. 728 (1984) 41
Helvering v. Griffiths, 318 U.S. 371 (1943) 36
James M. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991) 37, 39, 40, 42, 43, 44, 46, 47
Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) 28
Linkletter v. Walker, 381 U.S. 618 (1965) 43
Mackey v. United States, 401 U.S. 667 (1971) 45
McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 110 S. Ct. 2238 (1990) 39, 40
Miller Bros. v. Maryland, 347 U.S. 340 (1954) 6
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) ..... *passim*
Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978) 27, 33
Moragne v. States Marine Lines, Inc., 398 U.S. 375 (1970) 35, 36, 38
National Bank v. Whitney, 103 U.S. 99 (1880) 35
NCR Corp. v. Comptroller, 313 Md. 118, 544 A.2d 764 (1988) 16
Oklahoma v. Wells, Fargo & Co., 223 U.S. 298 (1912) 12
Patterson v. McLean Credit Union, 491 U.S. 164 (1989) 35, 36
Payne v. Tennessee, 111 S. Ct. 2597 (1991) 35, 38

TABLE OF AUTHORITIES—Continued

	Page
People ex rel. Alpha Portland Cement Co. v. Knapp, 230 N.Y. 48, 129 N.E. 202 (1920)	26
Phoenix v. Kolodziejski, 399 U.S. 204 (1970)	41
Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891)	8
Smoot Sand & Gravel Corp. v. Commissioner of Internal Revenue, 241 F.2d 197 (4th Cir.)	18
Standard Oil Co. v. Peck, 342 U.S. 382 (1952)	28
State Railroad Tax Cases, 92 U.S. 575 (1875)	8
Teague v. Lane, 489 U.S. 288 (1989)	45
Thomas v. Washington Gas Light Co., 448 U.S. 261 (1980)	35, 37
Trinova Corp. v. Michigan Dep't of Treasury, 111 S. Ct. 818 (1991)	32, 46
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920)	9
United States Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978)	15
United States v. Johnson, 457 U.S. 537 (1982)	43
Vasquez v. Hillary, 474 U.S. 254 (1986)	35, 36
Wallace v. Hines, 253 U.S. 66 (1920)	10, 12, 18-19
Welch v. Texas Highways & Public Transp. Dept., 483 U.S. 468 (1987)	35
Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1936)	21
Williams v. United States, 401 U.S. 646 (1971)	13
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)	6

Statutes

Cal. Rev. & Tax Code § 24344 (West 1992)	19
Mont. Code Ann. § 15-31-114(4) (1991)	19
MTC Reg.IV.1.(c) (3) (example v, vi)	16
MTC Reg.IV.1.(c) (4) (examples iv, vi)	16
MTC Reg.IV.18.(c)	26
N.J. Stat. Ann. § 54-10E-4(1) (2) (e) (1986)	19
Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (1985)	15

Other Authorities

G. Altman & F. Keesling, *Allocation of Income in State Taxation* (2d ed. 1950)	13

TABLE OF AUTHORITIES—Continued

	Page
G. Altman & F. Keesling, *Allocation of Income in State Taxation* (1946)	13
2 J. Bonbright, *Valuation of Property* 660 (1937)	13
P. Hartman, *Federal Limitations on State and Local Taxation* 26 (1981)	8
1 J. Hellerstein, *State Taxation* ¶ 9.12[2][6] at 554 (1983)	14, 17
Huston, *Allocation of Corporate Net Income for Purposes of Taxation*, 26 Ill. L. Rev. 725 (1932)	8
Isaacs, *The Unit Rule*, 35 Yale L.J. 838 (1926)	7
Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act, Part I*, 15 U.C.L.A. L. Rev. 156 (1967)	13
Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act, Part II*, 15 U.C.L.A. L. Rev. 655 (1968)	13
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The Federalist, No. 78, p. 440 (H. Lodge ed. 1888)	35

In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-615

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation, PETITIONER

v.

DIRECTOR, DIVISION OF TAXATION, RESPONDENT

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF PETITIONER ON REARGUMENT

INTRODUCTION

The order restoring this case to the calendar for reargument strongly suggests that this Court is not prepared to accept the New Jersey Supreme Court's semantic end-run around *ASARCO* and *Woolworth*. As New Jersey essentially conceded at oral argument, it cannot prevail in this case on the basis of interpretation and application of existing precedent. Hence New Jersey asks the Court to overrule *ASARCO* and *Woolworth* and to discard the unitary business principle on which they rest. In response to this request, the Court has posed the following three questions:

1. Should the Court overrule *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

SUMMARY OF ARGUMENT

There are essentially two ways in which the Court might "overrule" *ASARCO* and *Woolworth*. First, it might selectively abandon the doctrine that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle," *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), and hold that, with respect to intangibles, all of a taxpayer's income is apportionable regardless of whether any operational connection exists between the income and the taxpayer's business activities in the taxing state. Second, it might abandon the unitary business principle altogether and hold that all of a taxpayer's income from tangible as well as intangible assets is apportionable. Because each of these alternatives would jettison the sound constitutional postulates on which *ASARCO* and *Woolworth* squarely rest and would introduce more unfairness, more uncertainty, and more complexity than is even arguably encountered under the existing constitutional regime, *ASARCO* and *Woolworth* should be reaffirmed.

1. *The sound constitutional principles underlying* ASARCO *and* Woolworth. No rule is more firmly embedded in this Court's Commerce and Due Process Clause jurisprudence than the bedrock principle that a state may not tax activities with which it lacks a concrete connection. The unitary business principle reflects this rule. On the one hand, as a limited exception to the general proposition that a state may not look beyond its borders in exercising its tax power, the unitary business principle permits states to consider a taxpayer's out-of-state activities in determining its state tax liability when the taxpayer's out-of-state activities are organically related to its in-state activities. On the other hand, the unitary

business principle prevents states from considering a taxpayer's out-of-state activities when they are not organically related to the taxpayer's in-state activities.

For more than a century, the Court has faithfully adhered to the unitary business principle in determining the propriety of state tax apportionments with respect to both direct operating income and income from intangibles. *ASARCO* and *Woolworth* are sewn from the same fabric as these earlier decisions. Thus long-standing and well-reasoned decisions of this Court support the precise holding of *ASARCO* and *Woolworth* with respect to income from intangibles: A state may not include in a nondomiciliary corporation's apportionable tax base investment income unrelated to the corporation's business operations in the state simply because the investment activity served a general corporate purpose.

2. *The mischievous consequences of overruling* ASARCO *and* Woolworth. If the Court were to abandon the unitary business principle selectively, and hold all intangible income apportionable to every state in which the taxpayer has any taxable presence, it would create a wholly unsatisfactory regime for state taxation of multistate corporate income. Form rather than substance would govern the apportionability of income, with one rule applying to the apportionment of income from intangibles and another applying to the apportionment of income from tangibles, even though the taxpayer's relationship to the income in the two cases may be economically identical. Moreover, state tax apportionments would routinely violate the "external consistency" principle as intangible income would be apportioned by factors that did not reflect the way in which the income was generated. Courts would inevitably become more embroiled in questions bearing on the proper apportionment of intangibles, and state tax administration would become much more complex. Perhaps most significantly, the established, workable, and substantially uniform system of state laws governing taxa-

tion of investment income, which apportions income from intangibles employed in business operations and allocates other investment income, would be left in shambles.

If, on the other hand, the Court were to abandon the unitary business principle in its entirety, as New Jersey urged at oral argument, and hold that all of a taxpayer's income was apportionable regardless of its connection to the taxpayer's activities in the taxing state, it would shed the formalities of a rule that distinguished between intangible and direct operating income, but the results would be equally indefensible. Not only would such a rule create many of the problems identified above, the ensuing constitutional regime would also sanction gross misattribution of income. Some states would be permitted to tax out-of-state income, while others would be forbidden from taxing in-state income. To avoid the bizarrely unfair results that such a regime would spawn, courts would inevitably become more entangled with the details of controversies over the fairness of state tax apportionments.

3. *Stare decisis.* Considerations of *stare decisis* strongly favor the reaffirmation of *ASARCO* and *Woolworth*. The rules at issue here involve property interests, as to which the value of stability and the significance of reliance interests are most compelling. Indeed, the overruling of *ASARCO* and *Woolworth* would render unconstitutional the vast majority of the states' taxing schemes, which have been constructed around this Court's firmly established understanding of the prior law. Moreover, none of the customary indicia of the need for overruling is present. *ASARCO* and *Woolworth* are fully in harmony with the Court's Commerce and Due Process Clause jurisprudence and their soundness has not been questioned in subsequent cases.

4. *Retroactivity.* If *ASARCO* and *Woolworth* are overruled, the Court's decision should not apply retroactively.

The Court should apply the *Chevron Oil* test in determining whether new principles of law control the case before it. Application of that test dictates prospective application of a decision overruling *ASARCO* and *Woolworth* because such a decision would establish a new principle of law and would disrupt reasonable expectations concerning a vast range of transactions, confounding reliance interests of both taxpayers and states on the preexisting rule of law.

I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED BECAUSE THEY REFLECT SOUND AND DEEPLY ROOTED CONSTITUTIONAL RESTRAINTS ON STATE INCOME TAXATION OF MULTISTATE CORPORATIONS

Our understanding of the Court's reference to "overruling" *ASARCO* and *Woolworth* envisions a radical restructuring of the law governing state taxation of multistate corporations.[1] At a minimum, it suggests that the Court is considering selectively abandoning the unitary

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[1] In our view, therefore, "overruling" would not embrace any clarification the Court may see fit to make in language in *ASARCO* and *Woolworth* that could be read as precluding nondomiciliary states from apportioning intangible income in *all* cases in which the "business activities of the . . . payor have nothing to do with the activities of the recipient in the taxing State." *ASARCO*, 458 U.S. at 327, and *Woolworth*, 458 U.S. at 371 (both quoting *Mobil*, 445 U.S. at 442). Allied-Signal has never taken issue with the proposition that income from working capital or from assets serving an operational function under the *Corn Products* doctrine is properly apportionable by a nondomiciliary state in which a taxpayer does business without regard to the relationship between the payor and the payee. Allied-Signal Br. 40; Allied-Signal Rep. Br. 3. Hence we would not consider the Court's explicit acknowledgement of this proposition, which was never at issue in *ASARCO* and *Woolworth*, *ASARCO*, 458 U.S. at 337 & 337-38 n.5 (O'Connor, J., dissenting); Tr. of *Woolworth* Oral Argument at 16-17, and which was tacitly recognized in *Container Corporaiton of America v. Franchise Tax Bd.*, 463 U.S. 159, 180 n.19 (1983), as "overruling" *ASARCO* and *Woolworth*.

business principle by permitting any state in which a corporation does any business to tax an apportioned share of its intangible income regardless of the existence of an operational connection between such income and the corporation's business activity in the taxing state. More fundamentally, it suggests that the Court may be considering complete abandonment of the unitary business principle with respect to *all* income earned by multistate corporations, whether from tangible or intangible assets. As we demonstrate below, however, there is no theoretical or practical justification—with respect either to intangible income or to income generally—for the wholesale abandonment of the constitutional principles that have long guided state taxation of the income of multistate corporations.

A. The Unitary Business Principle, On Which *ASARCO* and *Woolworth* Squarely Rest, Embodies The Sound Constitutional Postulate That States May Not Tax Activities With Which They Have No Concrete Connection

The essential holding of *ASARCO* and *Woolworth*—that a state may not include in a nondomiciliary corporation's apportionable tax base investment income unrelated to the corporation's business operations in the state simply because the investment activity served a general corporate purpose—rests on the bedrock constitutional principle that there must be "some definite link, some minimum connection" between a state and the activity it seeks to tax. *Miller Bros v. Maryland*, 347 U.S. 340, 344-45 (1954). The underlying rationale for this virtually axiomatic proposition is that the exercise of a state's tax power over a taxpayer's activities is justified by the "protection, opportunities and benefits" the state confers upon such activities. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). If the state lacks a "definite link" or "minimum connection" with the activities in question, it has not "given anything for which it can ask return." *Id.*

When a state seeks to include income from a taxpayer's out-of-state activities in a taxpayer's apportionable tax base, the Court has consistently measured that "definite link" or "minimum connection" by reference to the unitary business principle. Under that principle, if a taxpayer is carrying on a single "unitary" business within and without the state, the state has the requisite connection to the out-of-state activities of the business to justify the inclusion in the taxpayer's apportionable tax base of all income generated by the combined effect of the out-of-state and in-state activities. By the same token, however, if the taxpayer's income-producing activities carried on within the state are not unitary with its income-producing activities carried on elsewhere, the state is constitutionally constrained from including the income arising from those out-of-state activities in the taxpayer's apportionable tax base when the taxpayer is not domiciled in the taxing state.

Although it was not until 1980 that the Court declared that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle," *Mobil*, 445 U.S. at 439, this principle, the Court was quick to point out, was not "new." *ASARCO*, 458 U.S. at 320 n.14. Indeed, "[i]t has been a familiar concept in our tax cases for over 60 years." *Id.* (citing cases).

The unitary business principle derives from the "unit rule" developed in the late 19th century for apportioning property values of railroad, telegraph, and express companies to state or local taxing jurisdictions. Isaacs, *The Unit Rule*, 35 Yale L.J. 838 (1926). To ascertain the value of a company's property that was properly attributable to the taxing jurisdiction, states and localities would determine the value of the entire operating system and then assign to the state or locality a proportion of the system value based on the ratio of the amount of some identifiable factor to the amount of such factor in the entire system. See, *e.g.*, *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 26 (1891) (track mileage);

Western Union Telegraph Co. v. Taggart, 163 U.S. 1, 18 (1896) (telegraph line mileage). When taxpayers complained that taxing jurisdictions were exceeding their power by taking account of extraterritorial values for purposes of determining the proper value of the taxpayer's property attributable to the taxing state or locality, the Court responded:

> But . . . a railroad must be regarded for many, indeed for most purposes, as a unit. The track of the road is but one track from one end of it to the other, and except in its use as one track, is of little value. In this track as a whole each county through which it passes has an interest much more important than it has in the limited part of it lying within its boundary. . . . It may well be doubted whether any better mode of determining the value of that portion of the track within any one county has been devised than to ascertain the value of the whole road, and apportion the value within the county by its relative length to the whole.

State Railroad Tax Cases, 92 U.S. 575, 608 (1875). The Court subsequently expanded the concept of the "unit rule" beyond cases in which there was a contiguous physical unity connecting the taxpayer's property in various states to cases in which there was operational—but no physical—unity. *Adams Express Co. v. Ohio*, 165 U.S. 194 (1897); *American Express Co. v. Indiana*, 165 U.S. 255 (1897); *Adams Express Co. v. Kentucky*, 166 U.S. 171 (1898).

When the Court began to confront constitutional challenges to apportioned net income taxes in the 1920's, it applied the same "unit rule" principles it had developed in adjudicating the constitutionality of apportioned property taxes. P. Hartman, *Federal Limitations on State and Local Taxation* 26 (1981); Huston, *Allocation of Corporate Net Income for Purposes of Taxation*, 26 Ill. L. Rev. 725, 728-32 (1932). The Court recognized that when corporate income was "largely earned by a series

of transactions beginning with manufacture in [one state] and ending with sales in other States," *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120 (1920), apportionment was a reasonable method for assigning the taxpayer's income to each of the various states in light of the "impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Id.* at 121; see also *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 132-33 (1931).

In delineating the contours of a unitary business, however, the Court never lost sight of the fact that the underlying unity was not comprised of everything that happened to be owned by the taxpayer:

> We repeat that while the unity which exists may not be a physical unity, *it is something more than a mere unity of ownership.* It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business.

Adams Express, 165 U.S. at 222 (emphasis supplied). In *Butler Brothers v. McColgan*, 315 U.S. 501 (1942), the Court reiterated that it was "unity of use and management of a business" that justified the state's inclusion of income generated by out-of-state activities in the apportionable tax base. *Id.* at 508 (citing *Adams Express*). In *Mobil*, the Court described a unitary business as one characterized by "functional integration, centralization of management, and economies of scale." *Mobil*, 445 U.S. at 438. And in *Container*, the Court emphasized the fundamental notion that to be unitary "the out-of-state activities of the purported 'unitary business' must be related in some concrete way to the in-state activities," and that there must be "some sharing or exchange of value not capable of precise identification—*beyond the mere flow of funds arising out of a passive investment or*

a distinct business operation." *Id.* at 166 (emphasis supplied).

The core holdings of *ASARCO* and *Woolworth*—that a state may not include in a taxpayer's apportionable tax base investment income not organically connected to its business activities in the state—flow inexorably from the Court's unitary business precedents. Such unrelated investment income simply does not derive from the business "unit" engaged in income-producing activities in the state. Consequently, there is no "unity of use . . . resulting from the very nature of the business" (*Adams Express*, 165 U.S. at 222) and no connection in any "concrete way" (*Container*, 463 U.S. at 166) between the taxpayer's out-of-state activities and the taxing state. There is merely income that contributes to the "pecuniary profit of the owner" (*id.*), a fact that, by itself, fails to link the income to the taxing state. Indeed, to have accepted the states' contentions in *ASARCO* and *Woolworth* (and New Jersey's contention here) that income is apportionable just because it "adds to the riches of the corporation" (*Wallace v. Hines*, 253 U.S. 66, 70 (1920)) would have ripped those cases from the fabric of the law that the Court has carefully woven over the past century. More significantly, it would have deprived the unitary business concept of its basic constitutional function, namely, to confine the exercise of a state's tax power to those activities to which it has accorded some palpable benefit.

B. The Specific Rule Governing *ASARCO* And *Woolworth*—That Investments Not Organically Related To The Taxpayer's Business In The Taxing State Must Be Excluded From The Apportionable Tax Base—Comports With The Well-Reasoned Decisions Of This Court And The Disinterested Views Of Academic Commentators

Beyond the fact that *ASARCO* and *Woolworth* faithfully reflect the general constitutional principles that lie at the heart of this Court's state tax jurisprudence, the

well-reasoned decisions of this Court and the views of disinterested academic observers demonstrate the essential wisdom of the specific principle of *ASARCO* and *Woolworth*, namely, that intangible invetments unrelated to a taxpayer's business operations may not be considered part of a unitary business.

Consequently, if this Court were to abandon this principle, it is not only *ASARCO* and *Woolworth* that the Court would have to overrule. In *Fargo v. Hart*, 193 U.S. 490 (1904), Indiana purported to apply the unitary business principles laid down in the earlier express company cases[2] to value the property of an interstate express business. Indiana treated the whole business as a unit and assessed the property on a proportion of the total value of its property determined by the ratio of the mileage in Indiana to the total mileage of the company.

A problem arose because the property that Indiana included in the taxable "unit" consisted not only of the real and personal property that the company used in its express business within and without Indiana, but also $15.5 million of bonds that it held in New York. Testimony showed that the bonds were not "necessary" for the express business carried on in Indiana and "in fact [were] not used" for such business. *Fargo*, 193 U.S. at 500. The Court held that the bonds could not constitutionally be included in the company's apportionable tax base. "The express business added nothing to the value of the bonds in New York." *Id.* "Conversely, the utmost extent to which those bonds entered into the value of property in Indiana was in so far as they helped to make the public believe that the express company could be trusted and therefore increased its good will." *Id.* This "attenuated relation[]" (*id.*) did not provide the essential "organic connection" (*id.* at 499) between the taxpayer's express business in Indiana and its out-of-state investment.

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[2] See *Adams Express Co. v. Ohio*; *American Express*; *Adams Express Co. v. Kentucky*.

The Court reaffirmed this holding in *Wallace v. Hines*, 253 U.S. 66 (1920). North Dakota sought to include the value of interstate railroads' stocks and bonds in their North Dakota apportionable property tax base. The Court unequivocally rejected the effort, citing the most basic of constitutional concerns. It observed that "[t]he *only* reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they would otherwise possess." *Id.* at 69 (emphasis supplied). The purpose is not, the Court continued "to expose the heel of the system to a mortal dart—not, in other words to open to taxation what is not within the State." *Id.* Consequently, the bonds secured by mortgage of lands in other States and other property that "adds to the riches of the corporation but does not affect the North Dakota part of the road" (*id.* at 70) could not be included in the apportionable tax base. *See also Oklahoma v. Wells, Fargo & Co.*, 223 U.S. 298, 300 (1912) (receipts from out-of-state investment in bonds could not be included in nondomiciliary express company's apportionable tax base on authority of *Fargo v. Hart*).

In *ASARCO* and *Woolworth*, the Court properly recognized the controlling force of its earlier decisions precluding states from taxing investments unrelated to nondomiciliary taxpayer's in-state business activities. *ASARCO*, 458 U.S. at 320 n.14, 328 (citing *Fargo* and *Wallace*); *Woolworth*, 458 U.S. at 354 (citing *Wallace*). The underlying rationale of this consistent line of decisions is as sound now as it was then.

Indeed, disinterested observers have long recognized that the *raison d'être* of the unitary business principle precludes the apportionability of investments not organically related to the taxpayer's in-state operations. As

Professor Bonbright noted in his classic treatise on valuation:

> The balance sheet of almost every modern corporation covers certain assets which are of little or no service to the going concern. These assets may include cash in excess of working-capital requirements; *securities held for investment rather than for control*; real estate no longer needed in the business and awaiting sale in a favorable market . . . .
>
> When assets of an interstate corporation are thus completely divorced from the interstate business, there is no good reason why they should be subject to assessment under the unit rule.

2 J. Bonbright, *Valuation of Property* 660 (1937) (emphasis supplied).

Likewise, two distinguished students of the unitary business principle,[3] have provided a pertinent illustration of why a taxpayer's investment income should not be included in its apportionable tax base. They posit the case of an interstate railroad company, which has accumulated large reserves invested in stocks and bonds of other companies, from which it derives substantial income in the form of dividends and interest. The investment activities are carried on in the headquarters office where the railroad operations are managed and controlled. Some

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[3] The writings of these men, Frank M. Keesling and John S. Warren, on the unitary business principle, have been cited frequently by the Court. *See* G. Altman & F. Keesling, *Allocation of Income in State Taxation* (2d ed. 1950) (cited in *Mobil*, 445 U.S. at 439 n.14); G. Altman & F. Keesling, *Allocation of Income in State Taxation* (1946) (cited in *Woolworth*, 458 U.S. at 371 n.25); Keesling & Warren, *The Unitary Concept in the Allocation of Income*, 12 Hastings L.J. 42 (1960) (cited in *Mobil*, 445 U.S. at 439 n.14, 445 U.S. at 453 n.5, 458-59 n.12 (Stevens, J., dissenting); Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act, Part I*, 15 U.C.L.A. L. Rev. 156 (1967) (cited in *ASARCO*, 458 U.S. at 326 n.22); Keesling & Warren, *California's Uniform Division of Income Tax Purposes Act, Part II*, 15 U.C.L.A. L. Rev. 655 (1968).

individuals devote their entire time to the investment activities, whereas others, including a number of officers, devote part of their time to both the investment activities and the railroad operations.

> Although both activities are commonly owned and managed, and there is some common use of personnel and facilities, and although some practical difficulties may be experienced in segregating the expenses of the investment activities, clearly it would be wrong to consider that the company is engaged in only one business and that the entire income of the company should be apportioned within and without the state by means of a formula. Notwithstanding the common elements, there are two distinct series of income-producing activities. This conclusion follows from the fact that the income from dividends and interest can be identified as being derived from the stocks and bonds and the activities related thereto, and not in any way attributable to the general railroad operations carried on within and without the state.

Keesling & Warren, *The Unitary Concept in the Allocation of Income*, 12 Hastings L.J. 42, 52-53 (1960) (citation omitted), see also 1 J. Hellerstein, *State Taxation* ¶ 9.12[2][b] at 554 (1983).

In short, unless this Court is prepared to abandon a century of precedent reflecting the sound constitutional principle that states may not tax activities to which they provide no benefit, *ASARCO* and *Woolworth* must be reaffirmed.

C. The Existing Regime Of State Taxation Of Investment Income Should Not Be Disturbed Because It Provides A Settled, Workable, And Substantially Uniform Solution To Potentially Troublesome Division-Of-Income Problems

The existing regime of state taxation of investment income has been shaped in large part by this Court's unitary business decisions. Most states have explicitly recognized

the distinction between apportionable and nonapportionable (or allocable) income, by virtue of their adoption of either the Uniform Division of Income for Tax Purposes Act (UDITPA), 7A Uniform Laws Annotated 331 (1985), or similar statutory schemes. 1 Multistate Corporate Income Tax Guide (CCH) ¶¶ 145, 167 (1992). Indeed, UDITPA's definition of apportionable "business income" is no different in substance from this Court's definition of income arising from a unitary business, to wit:

> income arising from transactions and activity in the regular course of the taxpayer's trade or business and includ[ing] income from tangible and intangible property, if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

UDITPA § 1(a). "Nonbusiness income," which is allocable to particular states, is defined as "all income other than business income." UDITPA § 1(e).

In drawing the line between apportionable and allocable investment income, the states generally employ the same criteria that this Court has embraced in distinguishing between apportionable "unitary" income and nonapportionable "nonunitary" income. Thus the regulations of the Multistate Tax Commission (MTC)[4] implementing UDITPA, which have been adopted by about one-third of the states with corporate income taxes, 1 Multistate Corporate Income Tax Guide (CCH) ¶ 145 (1992), provides that interest and dividends are apportionable or allocable depending on their relationship to the taxpayer's underlying business operations. For example, interest from working capital is apportionable "business" income whereas interest earned on funds de-

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[4] The Multistate Tax Commission is the administrative agency of the Multistate Tax Compact, which has adopted UDITPA. *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978); *ASARCO*, 458 U.S. at 310 n.3.

rived from the sale of a subsidiary's stock, pending a management decision as to how the funds are to be utilized, is allocable "nonbusiness" income. MTC Reg.IV.1 (c)(3) (examples v, vi), reprinted in 2 Multistate Corporate Income Tax Guide (CCH) ¶ 8162 (1991). Similarly, a construction contractor's dividends from securities held to maintain adequate bonding capacity are apportionable "business" income whereas a manufacturer's dividends from a stock portfolio unrelated to its manufacturing business are allocable "nonbusiness" income. MTC Reg.IV.1(c)(4) (examples iv, vi), reprinted in 2 Multistate Corporate Income Tax Guide (CCH) ¶ 8164 (1991).[5]

The vast majority of states explicitly recognize the distinction between apportionable and allocable investment income; in these states, allocable interest, dividends, and capital gains are assigned—almost without exception—to the taxpayer's commercial domicile. See the Appendix to this brief. This reflects the states' recognition that when investments are not used in the taxpayer's business operations so that there is no warrant for apportioning the income they generate, such income is properly attributable to the seat of the corporation's government. As this Court has observed, "[t]he economic advantages realized through the protection, at the place of domicil, of the ownership of rights in intangibles . . . support the taxation of intangibles at the place of domicil." *First Bank Stock Corp. v. Minnesota*, 301 U.S. 234, 241 (1937).

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[5] Even in states in which the line between apportionable and allocable income has not explicitly been drawn in the statute or regulations, courts have drawn lines that conform to the prevailing pattern. *See, e.g., American Home Products Corp. v. Limbach*, 49 Ohio St. 3d 158, 551 N.E.2d 201, *cert. denied*, 111 S. Ct. 63 (1990) (income from investments used as working capital apportionable; income from investments in excess of working capital nonapportionable); *NCR Corp. v. Comptroller*, 313 Md. 118, 544 A.2d 764 (1988) (income from investments timed to meet taxpayer's operating needs apportionable); see also Allied-Signal Br. 28 n.12.

Furthermore, the state of commercial domicile is typically where the taxpayer's activities in managing its investments occur.

The prevailing pattern of state taxation of investment income generally assures that there will be neither undertaxation nor overtaxation of such income. If the investment is used in the taxpayer's business, the income therefrom will be apportioned among the states in which the taxpayer conducts its business. On the other hand, if the investment is not used in the taxpayer's business, the income therefrom will be allocated to the taxpayer's commercial domicile, which is the state with the most significant connection to the taxpayer and, ordinarily, to its activities associated with the earning of such income.

Despite the existence of a workable, equitable, and substantially uniform framework for state taxation of investment income—a framework deeply rooted in the salutary constitutional principles that the Court has articulated over the years, *see* 1 J. Hellerstein, *State Taxation* ¶ 9.12[2][b] at 555 (1983), some Justices have nevertheless questioned both the logic and fairness of the existing regime. Justice O'Connor's dissenting opinion in *ASARCO* suggested that there is no principled distinction between working capital, the income from which is admittedly apportionable, and other "investments . . . triggered by [a corporation's] need to obtain a return on idle financial resources accumulated for the future operation of its own primary business." *ASARCO*, 458 U.S. at 337 (O'Connor, J., dissenting). In her judgment "[a]ny return ASARCO earned on such investments . . . would be functionally related to the conduct of its . . . business and, therefore taxable . . . on an apportioned basis as unitary business income." *Id.* at 338-39.

With all due respect, we believe that this analysis suffers from two weaknesses.[6] First, the distinction

[6] Allied-Signal need take no issue, however, with much of Justice O'Connor's dissenting opinion in *ASARCO*. For example, Justice

between working capital—capital currently used in business operations—and idle financial resources accumulated for the future operation of a business is well recognized and used for a variety of purposes.[7] The distinction broadly reflects the line between investments that are integrally related to a taxpayer's business operations and those that have only an attenuated relationship to such operations. This is the very line that this Court has properly drawn between apportionable and nonapportionable income. "Capital transactions," this Court has declared, "can serve either an investment function or an operational function." *Container*, 463 U.S. at 180 n.19. That distinction, which the Court had no trouble delineating in *Container*, marks the appropriate divide between assets that have some "organic connection" (*Fargo*, 193 U.S. at 499) to the taxpayer's business and therefore give rise to apportionable income, and those assets that merely "ad[d] to the riches of the corporation" (*Wallace*,

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O'Connor's opinion took the position that ASARCO's investment income, even if assumed to be passive, was nevertheless apportionable because the subsidiary companies were in the same industry as ASARCO. *ASARCO*, 458 U.S. at 335, 336. Even if this position had been adopted by the Court, it would not affect the result here because there is no suggestion that, in investing in ASARCO, Bendix ever relied on "the resources of information and expertise developed in its own . . . business." *Id.* at 337.

Justice O'Connor's opinion also took the position that the Court improperly characterized ASARCO's investments as passive, and that the investments were in fact operationally connected to ASARCO's non-ferrous metals business. *Id.* at 340-44. In this case, by contrast, it was stipulated that "Bendix and ASARCO were unrelated enterprises each of whose activities had nothing to do with the other." Stip. ¶ 62 (J.A. 169).

[7] *See, e.g., Government of Guam v. Federal Maritime Comm'n*, 365 F.2d 515 (D.C. Cir. 1966), *cert. denied sub nom. Pacific Far East Line, Inc. v. Guam*, 385 U.S. 1002 (1967); *Smoot Sand & Gravel Corp. v. Commissioner of Internal Revenue*, 241 F.2d 197, 207 (4th Cir.), *cert. denied*, 354 U.S. 922 (1957); *American Home Products*, 49 Ohio St. 3d at 161, 551 N.E.2d at 205.

253 U.S. at 70) and therefore give rise to income that is properly attributable to the taxpayer's commercial domicile, where the assets are typically managed.

Second, there is no warrant for the assumption underlying the *ASARCO* dissent that the "idle financial resources" in question constitute "[t]he interim investment of retained earnings prior to their commitment to a major corporate project." 458 U.S. at 338. The source of the funds could as easily have come from borrowing as from the company's own business operations; indeed, most of Bendix's funds for its acquisition of ASARCO were borrowed. (Stip. ¶ 52 (J.A. 167)).[8] Moreover, such "idle financial resources" may well be used for purposes wholly unrelated to the taxpayer's operations in the taxing state; they could be distributed as dividends to shareholders or employed in unrelated business operations in other states. The mere possibility that such funds might be used in the business in the future does not justify treating them as being used in the business now.

Justice O'Connor's *ASARCO* dissent also questions the fairness of assigning all of a taxpayer's investment income to its commercial domicile. The dissent reasoned that a domiciliary state's power to tax investment income depends on whether "it confers benefits on or affords protection to the investment activity" and that "[m]ere assertion of the arbitrary legal fiction that intangible prop-

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[8] The fact that Bendix deducted its interest expenses associated with the borrowing from its New Jersey income does not make the investment "unitary," as the dissent in *ASARCO* seems to suggest. *ASARCO*, 458 U.S. at 339. Bendix was simply following the law as written by the New Jersey legislature. New Jersey plainly could have denied Bendix the right to deduct expenses connected with income not taxable by New Jersey. Indeed, many states have provisions that so provide. *See, e.g.*, Cal. Rev. & Tax Code § 24344 (West 1992); Idaho Code § 63-3022(a)(1) (Supp. 1991); Mont. Code Ann. § 15-31-114(4) (1991). Even New Jersey has a provision denying interest expense deductions in circumstances not applicable here. N.J. Stat. Ann. § 54-10E-4(1)(2)(e) (1986).

erty is located at its owner's domicile" does not satisfy the benefits-or-protection standard. *Id.* at 346-47. The dissent further suggested that the functional basis on which the commercial domicile rule was supposedly based —that the intangibles "had become 'integral parts of some local business' " where the taxpayer "maintained 'the actual seat of its corporate government' " (*id.* at 347)—actually supported apportionment rather than allocation.

We respectfully submit that this analysis likewise suffers from two weaknesses. First, the commercial domicile rule rests not on an "arbitrary fiction" but on the very benefits-and-protection standard that the *ASARCO* dissent recognizes as controlling. The commercial domicile "contributes . . . to the corporation in the way of opportunities, protection, and benefits. . . ." Sabine, *Constitutional and Statutory Limits on Power to Tax*, 12 Hastings L.J. 23, 33 (1960). Moreover, the taxpayer's activities with respect to investments not operationally connected to its business[9] ordinarily occur at the taxpayer's commercial domicile.[10] Accordingly, whether viewed from the standpoint of the general benefits that a state accords to its domiciliaries or from the standpoint of the protection that the state of domicile typically provides to the taxpayer's investment activities, the state of commercial domicile has the strongest claim for taxing investment income unrelated to a taxpayer's business operations.

Second, the Court's endorsement of the commercial domicile rule on the ground that the intangibles "had become 'integral parts of some local business' " where the taxpayer "maintained 'the actual seat of its corporate government' " was designed to draw a distinction between

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[9] If the investments were operationally connected to the taxpayer's business, they would, of course, give rise to apportionable income.

[10] That was clearly the case here. It is undisputed that Bendix's investment activities occurred at its commercial domicile in Southfield, Michigan. Stip. ¶¶ 7-30 (J.A. 154-61).

legal domicile and commercial domicile, not between intangibles that were integrally related to a unitary business and intangibles that served an investment function. In *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936), on which the *ASARCO* dissenting opinion relies (458 U.S. at 347), the question was whether the state of a corporation's commercial domicile had the power to tax its intangibles in light of the traditional rule assigning intangibles to a corporation's legal domicile, (*i.e.*, the state of incorporation). The Court held that where a corporation maintained only the formal corporate records required by state law in its legal domicile, a "legal fiction" would "dominate realities" if the state of "the actual seat of its corporate government," the state in which "the management functioned," were denied the power to tax the intangibles. *Wheeling*, 298 U.S. at 211-12.

Consequently, the commercial domicile rule is wholly consistent with the view that a state's power to tax income from intangibles should depend on the benefits it confers upon the taxpayer or the activities associated with the generation of income. When a taxpayer's investments are not functionally related to business activities it carries on in other states, the state of commercial domicile plainly has the most powerful claim to such income. Indeed, the notion that assigning the income to the commercial domicile "disregard[s] the claims of other States in which the unitary business operates" (*ASARCO*, 458 U.S. at 347 (O'Connor, J., dissenting)) is predicated on the mistaken premise that the investments have an operational connection with such unitary business (in which case they would be apportionable even under *ASARCO* and *Woolworth*).

II. OVERRULING *ASARCO* AND *WOOLWORTH* WOULD DESTROY THE ESTABLISHED AND WORKABLE FRAMEWORK FOR DIVIDING CORPORATE INCOME AMONG THE STATES, AND ANY REPLACEMENT FOR THE PREVAILING CONSTITUTIONAL REGIME WOULD INCREASE COMPLEXITY, UNCERTAINTY, AND UNFAIRNESS

As we noted at the outset, the "overruling" of *ASARCO* and *Woolworth* envisions, at a minimum, the Court's embrace of a rule that would permit any state in which a corporation operates to tax an apportioned share of its intangible income. We further observed that it could well signify an even more dramatic revision of existing constitutional doctrine. In either event, by abandoning the fundamental principle that the in-state business must have a concrete operational connection with the activities the state seeks to tax, the Court would effectively be discarding not only *ASARCO* and *Woolworth* but also a century of precedent on which they rest.

The destruction of the constitutional framework that has long governed state taxation of interstate business would, however, mark only the beginning of the havoc that overruling *ASARCO* and *Woolworth* would wreak. Any new constitutional regime that the Court might plausibly construct out of the ruins of the old would engender problems at least as troublesome as those that it may pereceive in the existing system. Indeed, it could take another century to iron out the wrinkles in the Court's brave new world of state taxation before some 21st century Supreme Court abandons it for yet a "fairer" system of allocating and apportioning income among the states. Moreover, the overruling of *ASARCO* and *Woolworth* would have the immediate impact of rendering unconstitutional the laws of two-thirds of the taxing states, which allocate investment income to the commercial domicile (see Appendix), unless the Court is also willing to

tolerate rampant multiple taxation that will seriously jeopardize the national economy.

A. A Constitutional Regime Permitting States To Apportion All Of A Corporation's Intangible Investment Income Would Elevate Form Over Substance, Exacerbate Problems Of Fair Apportionment, And Render The Existing Taxing Schemes Of Most States Unconstitutional

If this Court were to overrule *ASARCO* and *Woolworth* and hold that all of a corporation's intangible investment income was apportionable regardless of the connection between such income and the taxpayer's in-state business activities, the resulting constitutional landscape would display the following features.

1. *Form Versus Substance*

Form rather than substance would govern the question whether income was apportionable. To return to the example that Allied offered at the first oral argument of this case, suppose that a corporation domiciled in Illinois operates a beauty parlor business through a division in New Jersey and a parking lot business through a division in California. Suppose further that the beauty parlor business has nothing to do with the parking lot business, other than the fact that both businesses are owned by a single corporation. If the corporation sold its parking lot business, New Jersey plainly could not include in the corporation's New Jersey apportionable tax base the income from that sale because it was derived from a "discrete business enterprise" (*Mobil*, 445 U.S. at 439) that was "distinct in any business or economic sense" (*id.*) from the corporation's activities in New Jersey.

Let us now assume, however, that the corporation decides to incorporate the California parking lot division in a separate subsidiary. The facts remain identical to those in the preceding paragraph except that now the

corporation sells the stock of the California subsidiary and realizes a gain on that sale. If all intangible investment income were apportionable regardless of the connection between such income and the taxpayer's in-state business activities, then New Jersey could include the income from the sale despite the fact that there had been no change in substance from the situation in which New Jersey was constitutionally precluded from including such income in the taxpayer's apportionable tax base.

Moreover, tax consequences would vary depending on whether investments were made in tangible or intangible assets. If the corporation decided to make a long-term investment for capital appreciation and settled on raw land in a growing area of Florida, which it purchased for $10 million and later sold for $20 million, the $10 million capital gain from the sale would not be includable in the corporation's New Jersey apportionable tax base. If, however, the corporation had instead settled on the stock of a nonferrous metals company like ASARCO as the focus of its long-term investment of $10 million and had realized $10 million gain from the sale of ASARCO's stock, the gain would be fully includable in the corporation's New Jersey apportionable tax base under a constitutional regime that sanctioned the apportionment of all intangible income. Yet the difference in the substance of the two transactions from New Jersey's vantage point is impossible to discern.

To be sure, the Court could eliminate the form-over-substance problem described above by holding that all income of a corporation doing business in a state is apportionable, regardless of the form in which it is received or its relationship to the taxpayer's operations in the state. Such an approach, however, would constitute an even more drastic restructuring of the constitutional framework governing state taxation and would create additional problems that we address below. See pp. 31-34 *infra*.

2. *Fair Apportionment*

If this Court were to hold that all of a corporation's intangible investment income is apportionable regardless of the connection between such income and the taxpayer's in-state business activities, the problem of fair apportionment would be greatly exacerbated, courts would become embroiled in endless controversies over the propriety of state tax apportionments, and the administrative complexity of state tax audits would increase dramatically.

As this Court has frequently recognized, "an apportionment formula must, under both the Due Process and Commerce Clauses, be fair." *Container*, 463 U.S. at 169 (citing cases). The first component of fairness is "internal consistency." *Id.* "The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.*

If intangible investment income were automatically included in a taxpayer's apportionable tax base, state tax apportionments would routinely violate the "external consistency" principle. The apportionable tax base would include large sums of intangible investment income unrelated to the taxpayer's unitary business activities. Yet the apportionment factors, typically comprised of the taxpayer's real and tangible personal property, its payroll, and its sales (1 Multistate Corporate Income Tax Guide (CCH) ¶ 146 (1992)), would principally "reflect the relative contributions of the activities in the various States to the production of the total unitary income." *Butler Bros.*, 315 U.S. at 509 (citation and internal quotation marks omitted). They would not "reflect a reasonable sense of how [the taxpayer's intangible] income is generated." [11]

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[11] Intangible property is almost universally excluded from the property factors of state tax apportionment formulas for general

The constitutional infirmity in such a theoretical mismatch between the apportionable tax base and the apportionment factors was recognized by Justice Stevens in his dissenting opinion in *Mobil*:

> [I]t is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income.

Mobil, 445 U.S. at 459 (Stevens, J., dissenting);[12] see also *People ex rel. Alpha Portland Cement Co. v. Knapp*, 230 N.Y. 48, 58-59, 129 N.E. 202, 206 (1920) (Cardozo, J.) (including income from nondomiciliary corporation's out-of-state intangible investments without reflecting such investments in the apportionment factors is unconstitutional).

The root of the problem lies in the fact that state income tax apportionment formulas were never designed to deal with large quantities of investment income, which has traditionally been excluded from the apportionable tax base and assigned to the taxpayer's state of commercial domicile. See Appendix. Consequently, if this Court were to discard the constitutional rules confining the apportionable tax base to income derived from a taxpayer's business activities, it would necessarily spawn a host of issues relating to the "external consistency" of state tax apportionments.

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business corporations. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 152 (1992). Similarly, receipts from sales of intangibles are usually excluded from the sales factor when the intangible income cannot be attributed to any income-producing activity of the taxpayer. *See* MTC Reg.IV.18.(c), reprinted in 2 CCH Multistate Corporate Income Tax Guide (CCH) ¶ 8387 (1991).

[12] The Court in *Mobil* never addressed the merits of this question, holding that it was not properly raised below. *Id.* at 441 n.15.

Courts would have to confront issues such as the following: how intangibles should be reflected in apportionment formulas; whether the concepts underlying formulas designed to apportion operating income are appropriate for formulas employed to apportion intangible income; whether there should be one rule for intangible income from passive investments and another for intangible income from functionally integrated, controlled subsidiaries; whether, in the latter case, taking account of all or a portion of the subsidiaries' factors would be proper, and, if proportional inclusion were deemed to be proper, whether the proportional inclusion should depend on the extent of ownership, the percentage of the subsidiaries' earnings and profits that were paid out as dividends, or other factors; and so on. See Amicus Brief of American Home Products Corp., et al.

These questions would also significantly complicate state tax administration. Taxpayers and state tax personnel would be required to devote considerable time and energy to the task of modifying apportionment factors to take appropriate account of the particular intangible income that was included in the tax base. The difficulties would be compounded by the different positions that tax administrators in various states would no doubt take with respect to the appropriate treatment of intangibles. And, unless this Court were to reconsider its opinion in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), which permitted the states to adopt inconsistent income tax apportionment formulas, the inevitable result would be an increase in multiple taxation as states experimented with various approaches to the apportionment of intangible income.

3. *The Constitutional Condemnation of Existing State Tax Laws*

Perhaps the most mischievous consequence of a constitutional rule sanctioning the apportionment of all intangible income is that it would leave the existing structure

of state tax laws in shambles. As noted above (at 14-17), the states have over the years developed a workable and substantially uniform system of state taxation of investment income predicated in large part on the constitutional guidelines that the Court has established in this domain. Under this system, intangible investment income that is not integrally related to the taxpayer's regular trade or business is generally allocated to the taxpayer's commercial domicile. The Court's overruling of *ASARCO* and *Woolworth* to permit nondomiciliary states to tax investment income not integrally related to a taxpayer's business would destroy this system.

If investment income were held to be generally apportionable by nondomiciliary states, this Court's decisions strongly suggest that the domiciliary state would be precluded from allocating such income to itself on an unapportioned basis. In *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952), the Court held that a domiciliary state lacked the power to tax personal property on an unapportioned basis when other states had the power to tax the property on an apportioned basis:

> The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. Otherwise there would be multiple taxation of interstate operations . . . .

Id. at 384-85. *See also Central Railroad Co. of Pennsylvania v. Pennsylvania*, 370 U.S. 607, 612 (1962); *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 447 (1979) ("[t]he corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full"). Most recently, the Court declared in *Mobil* that "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate" (445 U.S. at 444), defending against a multiple taxation claim its holding that the power of the domiciliary state to tax income from intangibles should not be "exclu-

sive" (*id.* at 446) when other states had power to tax the income on an apportioned basis.

The tax laws of the vast majority of states allocate investment income to the commercial domicile. These laws could not pass constitutional muster if nondomiciliary states were able to tax the investment income on an apportioned basis. Moreover, it is the *risk* and not solely the actuality of multiple taxation that deprives the domiciliary state of the power to allocate to itself income when other states have the power to apportion such income. *Mobil*, 445 U.S. at 444; see also *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 228-29 (1980). Thus granting nondomiciliary states the power to tax intangible income on an apportioned basis would bar domiciliary states from allocating such income, although many states' laws currently so provide.[13]

Furthermore, if we are wrong in our understanding of the Court's doctrine forbidding domiciliary states from allocating income that is apportionable by other states, the states' existing tax laws might survive but interstate commerce would suffer grievous harm. Under a constitutional regime in which a corporation's intangible income was allocable in full to the state of its commercial domicile

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[13] In the short run, therefore, until the states adjust their laws to take advantage of their newly recognized taxing powers, a decision permitting nondomiciliary states to tax all intangible income on an apportioned basis could pose serious problems for most states. While the Constitution would permit the states to tax an apportioned share of all intangible investment income, the state statutes would bar them from doing so, because such income, if not related to the taxpayer's business activities in the state, would be allocable to other states. Conversely, while the state statutes would authorize the states to allocate to themselves intangible investment income of domiciliary taxpayers, the Constitution would bar them from doing so, because such income would be apportionable elsewhere. This is just another example of the untoward and unexpected consequences that would ensue from the Court's abandonment of the established constitutional framework delineating state tax power.

yet at the same time apportionable in all of the states in which it operated, a multistate corporation would be subject to tax on close to 200 percent of its investment income. There would therefore be "an inexorable hydraulic pressure" (*American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 286 (1987)) for corporations to confine their operations to one state in frustration of the central purposes of the Commerce Clause.

B. A Constitutional Regime Permitting States To Apportion All Of The Income Of A Corporation Operating In The State Regardless Of The Connection Of The Income-Producing Activities To The State Would Create A System At War With Basic Notions Of Fairness And Common Sense And Would Require The Court To Assume A Much More Active Role In Reviewing State Tax Apportionments

We have shown above that a rule permitting the apportionability of income without regard to its relationship to the taxpayer's business activities in the state cannot be confined to intangible income without creating nonsensical distinctions between income from tangible and intangible assets. See p. 24, *supra*. Thus any principled "overruling" of *ASARCO* and *Woolworth* would have to abandon the unitary business principle altogether for purposes of determining apportionability. The apportionability of income would depend simply on whether it was earned by a corporation that is subject to the state's taxing jurisdiction. Indeed, counsel for New Jersey candidly conceded this point during the first oral argument of this case.[14]

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[14] QUESTION: I guess I don't know what you mean by a unitary business. I guess—is every business that's owned by the same company part of a unitary business?

MS. HAMILL: Yes.

QUESTION: Is that the only condition?

MS. HAMILL: Yes. Would say because—

[Continued]

If this Court were to scrap the doctrine that "the linchpin of apportionability . . . is the unitary-business principle," Mobil, 445 U.S. at 439, and replace it with the doctrine that the "linchpin of apportionability is ownership," the consequences would be as unpalatable as those resulting from the abandonment of the unitary business principle solely for intangible income.

1. *Misattribution of Income*

In addition to the problems of fair apportionment identified above (see pp. 25-27), a constitutional regime that allowed states to apportion all income earned by corporations subject to their jurisdiction would create severe problems of income misattribution. To return to the example of a corporation with a beauty parlor business in New Jersey and an unrelated parking lot business in California, suppose that the corporation's apportionment percentage was 50 percent each for California and New Jersey, based on its property, payroll, and sales in the respective states. Suppose further that the parking lot business generated $1 million of income, whereas the beauty parlor business broke even. Under an everything-is-apportionable regime, New Jersey could require that the corporation include the full $1 million in its apportionable tax base and would be entitled to tax $500,000 of income generated by the California parking lot business, even though New Jersey had no meaningful connection to the activities that produced the income. By the same token, although the full $1 million was earned

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[14] [Continued

QUESTION: So there's really no inquiry to be made at all.
MS. HAMILL: That's—yes—
QUESTION: So long as it's owned by the same corporation.
MS. HAMILL: Yes, that's right.
QUESTION: That's what I thought.
MS. HAMILL: That is New Jersey's position. And I'd like to say otherwise. . . .

Tr. of Oral Argument at 31-32.

from California activities, California would be deprived of the right to tax the half apportioned to New Jersey. A dollar more of apportionable income for New Jersey would mean a dollar less for California.

The blatant unfairness of such a taxing system is self-evident. Not only is the New Jersey taxpayer saddled with a tax burden that bears no relationship to the income earned in the state, but California, the state with the legitimate claim to the portion of the tax base that is arbitrarily assigned to New Jersey, is stripped of the right to tax its fair share of the taxpayer's earnings. Moreover, the fact that half of any New Jersey beauty parlor income would have been taxed by California hardly cures the problem. Indeed, the Court has recognized the dangers inherent in a scheme of apportionment that loses sight of the fact that it is justified only by the difficulty of identifying the source of income derived from in-state and out-of-state activities that are inextricably interconnected:

> We can accept the premise that apportionment is permitted only when precise geographic measurement is not feasible, *for to allow apportionment where there is no practical or theoretical justification could provide the opportunity for a state to export tax burdens and import tax revenues.*

Trinova Corp. v. Michigan Dep't of Treasury, 111 S. Ct. 818, 829 (1991) (emphasis added).

Several Justices likewise recognized the same danger at the first oral argument in this case. One Justice, addressing a hypothetical involving a taxpayer's profitable Tennessee forest products business with no connection to its unprofitable New Jersey operations, observed: "I don't know why they should have to pay for the losses in New Jersey. The whole business is just run out of Tennessee, it has no connection with the other states." Tr. of Oral Argument at 44. Another Justice pointed out that where you have "an entirely separate operation . . . the reason

why the unitary business concept was developed simply doesn't apply." *Id.* at 37-38.

The utterly irrational results emanating from an everything-is-apportionable regime—results that are alien to rudimentary concepts of fairness and logic—warrant its dismissal out of hand.

2. *Increased Judicial Monitoring of State Tax Apportionment*

If the Court nevertheless accepted New Jersey's request to replace the unitary business principle with ownership as the "linchpin of apportionability," the manifestly unfair results of the kind described above would undoubtedly intensify the pressure on this Court, and on courts generally, to police more closely the fairness of state tax apportionments. Without the unitary business principle to serve as a prophylactic device to confine the tax base to income arising from a related set of activities, there would inevitably be an increase in state tax apportionments that bore no reasonable relationship to the taxpayer's activities in the state. Consequently, courts would increasingly be compelled to adjudicate the question whether particular apportionments were "fair."

By adopting a rule of apportionability that would necessitate increased judicial involvement in state tax apportionment controversies, the Court would be undoing all it has accomplished over the past 15 years to establish workable guidelines governing state tax apportionment and to limit its own role in this area. The Court's decisions in *Moorman*, *Mobil*, *Exxon*, *ASARCO*, *Woolworth*, and *Container* reflect a coherent vision of the essential constitutional limits on the states' power to impose apportioned state income taxes and on the Court's role in enforcing them. We have delineated these limits in considerable detail both here and in our earlier briefs, and there is no need to do so again at this juncture. If the Court were to abandon the "well established" legal principles bearing on state tax apportionment, it would

be inviting an outpouring of litigation in which it would inevitably become entangled.

C. If *ASARCO* And *Woolworth* Are Overruled, The Principles Governing State Taxation Of Multistate Corporations Should Be Designed To Assure Rationality In State Taxing Schemes, Avoid Duplicative Taxation, And Prevent Misattribution Of Income

If this Court were to overrule *ASARCO* and *Woolworth*, the Court should seek to avoid the problems we have identified above that will inevitably result from abandoning the existing constitutional regime governing state taxation of multistate business. In particular, we would urge the Court to make it clear that substance rather than form must determine state tax liabilities; that formulas for apportioning income must fairly reflect the way in which apportionable income is earned; that no state is entitled to allocate entirely to itself income that is apportionable by other states; and that the claims of unfair apportionment must be accorded heightened scrutiny in light of the increased risk of distortion resulting from the broadening of the apportionable tax base. We submit that the existing regime accords with these principles far better than any conceivable alternative.

III. CONSIDERATIONS OF *STARE DECISIS* STRONGLY FAVOR REAFFIRMATION OF *ASARCO* AND *WOOLWORTH*

Against this background, *ASARCO* and *Woolworth* should be reaffirmed for the best of reasons: they were correctly decided, stating the rule that most fully effectuates the purposes of the constitutional proscription on extraterritorial taxation. But even if the Court disagrees with that proposition—even if, in other words, it is now of the view that the questions presented in *ASARCO* and *Woolworth* would be decided differently today were they matters of first impression—considerations of *stare decisis* should lead the Court to reaffirm the holdings of those decisions.

1. "The Court has said often and with great emphasis that 'the doctrine of *stare decisis* is of fundamental importance to the rule of law,'" serving a central role in the "fashioning and preserving [of] a jurisprudential system that is not based upon 'an arbitrary discretion.'" *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989), quoting *Welch v. Texas Highways & Public Transp. Dept.*, 483 U.S. 468, 494 (1987), and *The Federalist*, No. 78, p. 440 (H. Lodge ed. 1888). As Justice Harlan explained for the Court:

> Very weighty considerations underlie the principle that courts should not lightly overrule past decisions. Among these are the desirability that the law furnish a clear guide for the conduct of individuals, to enable them to plan their affairs with assurance against untoward surprise; the importance of furthering fair and expeditious adjudication by eliminating the need to relitigate every relevant proposition in every case; and the necessity of maintaining public faith in the judiciary as a source of impersonal and reasoned judgments.

Moragne v. States Marine Lines, Inc., 398 U.S. 375, 403 (1970). See, *e.g.*, *Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991); *Vasquez v. Hillery*, 474 U.S. 254, 265 (1986); *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980) (plurality opinion). As a consequence, the Court consistently has held that "any departure from the doctrine of *stare decisis* demands special justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984).

The Court also has made clear the factors that bear on this inquiry. For over a century the Court has emphasized that "[c]onsiderations in favor of *stare decisis* are at their acme in cases involving property and contract rights" (*Payne*, 111 S. Ct. at 2610); holdings in those areas will not be disturbed "except for the most cogent reasons, certainly not because of subsequent doubts as to their soundness." *National Bank v. Whitney*, 103 U.S. 99, 102 (1880). And as a general matter, the only

"detours from the straight path of *stare decisis* in [the Court's] past have occurred * * * when the Court has felt obliged 'to bring its opinions into agreement with experience and with facts newly ascertained.'" *Vasquez*, 474 U.S. at 266, quoting *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 412 (1932) (Brandeis, J., dissenting). That typically has been so only when the decision in question was "decided before some important developments in the constitutional law" (*Alabama v. Smith*, 490 U.S. 794, 802 (1989)) and therefore did "not fit into [the Court's current] analytical framework" (*Collins v. Youngblood*, 110 S. Ct. 2517, 2521 (1990)), or otherwise "has caused confusion" in the courts. *Collins*, 110 S. Ct. at 2722. See, *e.g.*, *Patterson*, 491 U.S. at 173; *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 342-343 (1989); *Arkansas Electric Cooperative Co. v. Arkansas Public Utility Comm'n*, 461 U.S. 375, 391 (1983); *Moragne*, 398 U.S. at 404-405.

2. All of these considerations plainly militate against a departure from precedent here. *First*, the rules at issue in *ASARCO* and *Woolworth* involve property interests where "[t]he confidence of people in their ability to predict the legal consequences of their actions is vitally necessary to facilitate the planning of primary activity." *Moragne*, 398 U.S. at 403. The value of stability in the principles governing taxation (and the reliance of taxpayers on those principles) is manifest. A host of every taxpayer's business decisions—relating both to its plans for the future and to conduct undertaken in the past (such as its acquisition of intangible property that is now producing dividend income or that is expected to produce a capital gain on resale)—have been affected by the constitutional limits on state taxing authority. Cf. *Helvering v. Griffiths*, 318 U.S. 371, 402-403 (1943). Even leaving aside questions of retroactivity,[15] changing those limits

[15] According retroactive application to a decision overruling *ASARCO* and *Woolworth* would, of course, greatly magnify its

and upsetting those business judgments surely defeats "the broader societal interests in evenhanded, consistent, and predictable application of legal rules." *Thomas*, 448 U.S. at 272 (plurality opinion).

The defeat of reliance interests, moreover, would not be limited to the taxpayer side of the equation. As we have explained (at pages 27-30, *supra*), the taxing schemes of the 30 states that allocate to themselves 100% of their domiciliaries' intangible nonbusiness income (see App., *infra*) would be rendered unconstitutional by a decision overruling *ASARCO* and *Woolworth*. And the budgets of these states (again even leaving aside any question of retroactivity)—their plans for providing services, setting the rates of other taxes, and so on—are based on assumptions about revenue that derive from the existing constitutional rules. The disruption that would follow from the setting aside of those rules may be easily imagined.

Second, this is not a case where there is "difficulty [in] harmonizing" *ASARCO* and *Woolworth* with the rest of this Court's jurisprudence. To the contrary, as we explain above, those decisions are, if not compelled by, at least wholly consistent with the Court's broader Due Process and Commerce Clause doctrine. Nor are they in tension with any subsequent rulings; *Container Corp.*, the only more recent decision to address the unitary business principle in any detail, took pains to demonstrate the consistency of its holding with the reasoning of *ASARCO* and *Woolworth*. See 463 U.S. at 176-177 n.15, 177 n.16, 178-180. By the same token, those decisions have not spawned

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disruptive effects. We argue below that such a decision should not be applied retroactively. If the Court were to find retroactivity constitutionally compelled, however, the extraordinary dislocation that would ensue is further reason not to overrule *ASARCO* and *Woolworth* in the first place. Cf. *James M. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2450 (1991) (Blackmun, J., concurring in the judgment); *id.* at 2451 (Scalia, J., concurring in the judgment).

confusion or uncertainty. In fact, as we note in our opening brief (at 28 n.12), virtually all state courts—with the exception of the one below—have had little difficulty in faithfully adhering to the doctrine of *ASARCO* and *Woolworth*.

Finally, none of the objective indicia that suggest the propriety of departing from precedent is present in this case. *ASARCO* and *Woolworth* were not "decided by the narrowest of margins." *Payne*, 111 S. Ct. at 2611. They have neither "been questioned by members of the Court in later decisions" nor have they "defied consistent application by the lower courts." *Ibid.* And they certainly were not "judicial atrocities" (*Arkansas Electric Cooperative*, 461 U.S. at 273) that may be lightly discarded. In such circumstances, there is no principled ground on which *ASARCO* and *Woolworth* may be overruled without also opening to relitigation "every relevant proposition in every case." *Moragne*, 398 U.S. at 403.

IV. IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE DECISION SHOULD NOT BE RETROACTIVE

If the Court chooses to overrule *ASARCO* and *Woolworth*, it must face the question whether to compound the resulting chaos in state tax administration by applying its decision retroactively. Doing so would have dramatic consequences. It would free states like New Jersey, which have had statutes on the books purporting to permit the taxation even of those portions of a nondomiciliary's income that are not related to its in-state activities, to seek back taxes from all nondomiciliary taxpayers over whom they have jurisdiction. At the same time, as we explain above, the taxing schemes of states that allocate to themselves 100% of their domiciliaries' intangible income (or of discrete portions of that income) likely would be rendered unconstitutional by a decision overruling *ASARCO* and *Woolworth*; if such a decision were retroactive, the 30 states in that category could be required, under the

rule of *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990), "to provide meaningful backward-looking relief" in the form of refunds. *Id.* at 2247.

Whether such unsettling and disruptive retroactive consequences are avoidable when the law takes a radical change in direction, of course, is a matter that has closely divided the Court in recent years. In *American Trucking Ass'ns, Inc. v. Smith*, 110 S. Ct. 2323 (1990) ("ATA"), the plurality was of the view that decisions announcing new rules of law do not necessarily "appl[y] to conduct or events that occurred before the date of the decision" (*id.* at 2330), explaining that retroactivity in such circumstances is governed by the three-part *"Chevron Oil* test." See *id.* at 2331, referring to *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). The *ATA* dissent, in contrast, concluded that the Court must apply its current understanding of the law in every case, while adding that equitable remedial principles may be invoked in certain cases to limit the relief available to the prevailing party when a decision has been overruled. See *ATA*, 110 S. Ct. at 2347-2348 (Stevens, J., dissenting). As matters now stand, four current Members of the Court have taken the position that new rules of law may, in appropriate cases, be applied prospectively (see *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2449 (1991) (White, J., concurring in the judgment); *id.* at 2451 (O'Connor, J., dissenting); *ATA*, 110 S. Ct. at 2336-2343 (plurality opinion); three evidently are of the view that new rules must be applied retroactively in all cases (see *James Beam*, 111 S. Ct. at 2449-2450 (Blackmun, J., concurring in the judgment); *id.* at 2450-2451 (Scalia, J., concurring in the judgment); *ATA*, 110 S. Ct. at 2350-2356 (Stevens, J., dissenting)); one has expressly left open the question whether "pure prospectivity" ever is permissible (see *James Beam*, 111 S. Ct. at 2448 (opinion of Souter,

J.); one (Justice Thomas) has had no occasion to address the issue.[16]

This disagreement between the *ATA* plurality and dissent is of crucial importance here. If the Court overrules *ASARCO* and *Woolworth*, the *ATA* plurality's approach would then require application of the *Chevron Oil* test; since (as we demonstrate below) that test dictates nonretroactivity, the new post-*ASARCO* rule announced in this case would not be applied to the parties here and New Jersey would be precluded from collecting taxes for periods prior to the Court's decision. The approach taken by the *ATA* dissent, in contrast, would apply the post-*ASARCO* rule into the past and therefore might well permit New Jersey to collect the taxes at issue.[17] We

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[16] A plurality of the Court in *James Beam* concluded that "it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so." 111 S. Ct. at 2446 (opinion of Souter, J.). See *id.* at 2448-2449 (White, J., concurring in the judgment). But that would not be the situation here, of course, since no one has yet gotten the benefit of a post-*ASARCO* rule. As a consequence, prospectivity in this case (should *ASARCO* and *Woolworth* be overruled) would not involve the " 'selective application of new rules,' " a prospect that substantially underlay the *ATA* dissent. *See* 110 S. Ct. at 2350 (Stevens, J., dissenting), quoting *Griffith v. Kentucky*, 479 U.S. 314, 323 (1987).

[17] The *ATA* dissent acknowledged that, even when new rules are applied retroactively, the Court may retain the discretion to limit the retroactive *remedies* available under those rules. Here, the availability of such remedies should *ASARCO* and *Woolworth* be overruled would be determined in the first instance by state law rather than federal remedial principles (see *James Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.); as a consequence, if the Court discards those precedents and concludes that the new rule should be applied retroactively, it should remand rather than affirm so that the New Jersey courts have an opportunity to decide whether state law permits the collection of taxes in these circumstances. It also is possible that the Due Process Clause might preclude the retroactive collection of taxes in a case such as this one. Cf. *McKesson*, 110 S. Ct. at 2252 n.23. These questions need not be confronted if the Court adopts the approach of the *ATA* plurality.

therefore turn to the controlling question here: whether to view retroactivity "as a choice of law rule [or] . . . as a remedial principle." *ATA*, 110 S. Ct. at 2348 (Stevens, J., dissenting).

A. The Court Should Apply The *Chevron Oil* Test In Determining Whether New Principles Of Law Control The Case Before It

We submit that the *ATA* plurality's approach better accords both with this Court's precedents and with the general understanding of retroactivity. The issues were addressed at length by the Court in *James Beam* and *ATA*, and we will not rehearse the arguments here. In our view, however, several points bear special emphasis.

1. As an initial matter, whether or not the *ATA* dissent's characterization of retroactivity as a matter of remedy is, strictly speaking, consistent with the Court's prior holdings, that characterization appears out of step with the Court's past understanding of its decisions. The Court's civil rulings limiting retroactivity typically contain language indicating that "the decision will not apply" to past conduct, or that "we will apply our decision in this case prospectively." *Cipriano v. City of Houma*, 395 U.S. 701, 706 (1969). See also, *e.g.*, *Chevron Oil*, 404 U.S. at 106-107 ("'a holding of nonretroactivity'"); *Phoenix v. Kolodziejski*, 399 U.S. 204, 214 (1970) ("[o]ur decision in this case will apply only to" specified conduct). Cf. *Heckler v. Mathews*, 465 U.S. 728, 746 (1984) ("We have recognized, in a number of contexts, the legitimacy of protecting reasonable reliance on prior law even when that requires allowing an unconstitutional statute to remain in effect for a limited period of time"). This sort of language—stating that "a decision will not apply" to past conduct—surely is most naturally read as meaning that the *rule* announced in that decision will not apply. The lower courts, practitioners, and commentators therefore have understood the Court's retroactivity decisions to state "a doctrine or set of rules for determining when

past precedent should be applied to a case before the court." *ATA*, 110 S. Ct. at 2350 (plurality opinion). See *id.* at 2340 & n.2 (citing commentary).

The reasons that have impelled the Court to adopt that approach to retroactivity are manifest. Public officials and the citizenry at large are entitled to rely on this Court's statements of the law, and "[t]he utility of [the Court's] retroactivity doctrine in cushioning the sometimes inequitable and disruptive effects of law-changing decisions is clear." *ATA*, 110 S. Ct. at 2342 (plurality opinion). There accordingly is no compelling reason to depart from the long-settled understanding that, "'[w]here a decision of this Court could produce substantial inequitable results if imposed retroactively, there is ample basis in [the Court's] cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity.'" *Chevron Oil*, 404 U.S. at 107, quoting *Cipriano*, 395 U.S. at 706.

It nevertheless has been suggested that the disruptive effects of mandatory retroactivity actually serve valuable purposes by discouraging departures from precedent and acting as a "check[] upon judicial law making." *James Beam*, 111 S. Ct. at 2451 (Scalia, J., concurring in the judgment). For our part, however, we question whether society is well-served by a rule that puts the Court to the choice of, on the one hand, retaining in force a concedely incorrect understanding of the Constitution (a choice that is particularly unpalatable to those who believe that judges should make law "as though they were 'finding' it" (*ibid.* (emphasis omitted)), or, on the other, causing potentially intolerable disruptive effects by its holdings.[18]

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[18] In any event, the *ATA* dissent itself acknowledged that the Court often will be able to cushion the impact of its decisions through the choice of a nonretroactive *remedy*. The dissent's approach therefore is a very imperfect check upon judicial action: it is difficult to see how the force of precedent is significantly furthered by a choice of law rule that discourages the overruling of

2. The principal challenge to the approach of the *ATA* plurality has been grounded upon the suggestion that limiting retroactivity somehow is inconsistent with the judicial role. See *James Beam*, 111 S. Ct. at 2449-2450 (Blackmun, J., concurring in the judgment); *id.* at 2450-2451 (Scalia, J., concurring in the judgment). But there plainly is no Article III or other constitutional defect in the *ATA* plurality's approach. The Court repeatedly has held that there is no constitutional requirement of retroactivity. See, *e.g.*, *United States v. Johnson*, 457 U.S. 537, 543 (1982), citing *Great Northern Ry Co. v. Sunburst Oil & Refining Co.*, 287 U.S. 358, 364 (1932). And the formal notion that judges "find" rather than "make" rules does not dictate retroactivity; the Court consistently has refused to " 'indulge in the fiction that the law now announced has always been the law.' " *Chevron Oil*, 404 U.S. at 107 (citation omitted). See, *e.g.*, *Williams v. United States*, 401 U.S. 646, 651 (1971) (plurality opinion); *Linkletter v. Walker*, 381 U.S. 618, 622 n.3 (1965).

There undeniably is, moreover, a real controversy between the parties in a case such as this one (the State wants Bendix's money and Bendix does not believe it should have to pay), whatever the Court's ultimate choice of law. And a holding of nonretroactivity is hardly advisory; the Court's opinion in such a case simply explains its rationale for choosing a particular rule and applying that rule (or failing to apply it) to particular facts. A decision of that sort is similar in principle to, and relies upon the same considerations of policy as, a conclusion that a prior holding was wrongly decided but should not be overruled so as to protect the litigants' (and the public's) reliance interests. See, *e.g.*, *Flood v. Kuhn*, 407 U.S. 258, 282-284 (1972).

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decisions only in those areas where the Court fortuitiously has no remedial discretion. Allowing the nature of the choice of law rule to be dictated by the perceived value of retroactivity in those cases would have a very small practical tail wagging a very large theoretical dog.

In fact, as the *ATA* plurality explained, principles of nonretroactivity long have been understood to be an element of the doctrine of *stare decisis*. 110 S. Ct. at 2340-2341, citing *Sunburst*, 287 U.S. at 364 (Cardozo, J.). Certainly, if it is appropriate for the Court to protect the public's expectation interests by declining to overrule a decision that is thought to have been wrongly decided, it is equally proper to allow courts, by means of prospective overruling, "to respect the principle of *stare decisis* even when they are impelled to change the law in light of new understanding." *ATA*, 110 S. Ct. at 2341 (plurality opinion). Justice Scalia offered a related analysis in *ATA*, where he concluded that a Justice who disagrees with a decision that overruled precedent may decline to apply that decision to conduct that had been undertaken in reliance on the precedent; in such circumstances, *stare decisis* principles permit a departure from the more recent decision so as not to "upset * * * settled expectations." *Id.* at 2345 (Scalia, J., concurring in the judgment) (emphasis omitted). We add only that, if Justice Scalia's understanding of *stare decisis* is correct—and we believe it is—it is not at all clear why it should be inconsistent with the judicial role for a judge who *agrees* with a decision to decline to apply that decision's rule so as to protect those same expectation interests.

There is nothing new in this conclusion: the Court consistently has taken into account such considerations "of a practical sort" in settling the retroactive reach of its decisions. *James Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.). In civil cases, for example, the Court will not allow "a new rule [to] reopen the door already closed" by principles of res judicata or by statutes of limitations, even though those limits on retroactivity are in some sense "arbitrary" (*id.* at 2446); the Court denies complete retroactive effect to the new rule so as to advance independent interests in finality. See *id.* at 2447. The Court has applied the same sort of practical judgment in the application of retroactivity in the setting

of habeas corpus, adopting an approach, first propounded by Justice Harlan in *Mackey v. United States*, 401 U.S. 667, 675 (1971) (opinion of Harlan, J.), that accords most constitutional decisions nonretroactive effect in habeas proceedings. *Teague v. Lane*, 489 U.S. 288, 299-310 (1989) (plurality opinion). Again, if considerations of finality and reliance may justify disregard of "current constitutional law" in such proceedings (*Mackey*, 401 U.S. at 686 (opinion of Harlan, J.)), there is no reason to find it inconsistent with the judicial function for a judge, looking to similar policies, to decline to apply new law in a case such as this one.

B. The *Chevron Oil* Test Would Preclude Retroactive Application Of A Decision Overruling *ASARCO* and *Woolworth*

If limits on retroactivity are permissible, it remains to apply *Chevron Oil*'s three-part test here. The test's elements have become familiar:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, * * * we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. Finally, we [must] weigh[] the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity.

Chevron Oil, 404 U.S. at 106-107 (citations and internal quotation marks omitted). If the Court were to overrule *ASARCO* and *Woolworth* here, this case is a paradigm of one in which the decision should not be given retroactive effect.

1. By definition, the first element of *Chevron Oil* would be satisfied if the Court set aside the holdings of *ASARCO* and *Woolworth*. In such circumstances, the Court plainly would have "overrul[ed] clear past precedent on which litigants may have relied"—a conclusion that draws added force from the recognition that, as we explain above, *ASARCO* and *Woolworth* themselves rested squarely on a long line of this Court's decisions. Such a holding, moreover, would not have been foreshadowed by intervening decisions. To the contrary, in *Container Corp.* the Court discussed the holdings of *ASARCO* and *Woolworth* in considerable detail without so much as hinting at dissatisfaction with their reasoning. See 463 U.S. at 176-177 n.15, 177 n.16, 178-180. And just last Term the Court quoted from *ASARCO* with approval. *See Trinova Corp.*, 111 S. Ct. at 834. The break with existing law should *ASARCO* and *Woolworth* be overruled accordingly would be clear.

2. The second prong of the *Chevron Oil* test also points away from retroactivity. If there has been a clear break in the law, this element of the formula looks to whether retroactivity nevertheless is necessary "to deter deliberate violations or grudging compliance" with the law (*Florida v. Long*, 487 U.S. 223, 230 (1988)), or otherwise to advance federal policies. See, *e.g.*, *id.* at 236-237; *Chevron Oil*, 404 U.S. at 107-108. That is not the case here. There is absolutely no reason to suppose that retroactive application would assist in "ensur[ing] compliance with [the Court's] decision[]" (*Long*, 487 U.S. at 235) on the part either of taxpayers or of state officials. And the purpose of the Due Process Clause in this setting—assuring that states do not tax values with which they have no connection—"is fully served if States are, from the date of [a decision overruling *ASARCO* and *Woolworth*], prevented from enacting [unconstitutional] tax schemes." *James Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting).

3. Finally, the equities here would cut powerfully against retroactivity. A great many firms that justifiably believed themselves to be in compliance with state tax law—and that made investment and other spending decisions accordingly—would suddenly find themselves with substantial back tax bills should a decision overruling *ASARCO* and *Woolworth* be made retroactive. Other firms that allocated and paid tax on 100% of the investment income to their state of commercial domicile would be subject to substantial double taxation if their home-state tax years have been closed, but the same years remain open in many nondomiciliary states that would insist on taxing an apportioned share of the same income. The disruptive effect that such unanticipated (and unanticipatable) liability would have on those businesses and their employees is obvious.

At the same time, those allocation states whose tax systems would be rendered unconstitutional by a decision overruling *ASARCO* and *Woolworth* would face potentially devastating liability for refunds if the ruling were given retroactive effect. The untoward consequences of such liability often have been chronicled by the Court: it could "deplete the state treasury, thus threatening the State's current operation and future plans" (*ATA*, 110 S. Ct. at 2333 (plurality opinion)); it could necessitate tax increases (see *Arizona Governing Committee v. Norris*, 463 U.S. 1073, 1106-1107 (1983) (opinion of Powell, J.)); and it ultimately would fall on the public at large in the form of reduced services. See *James Beam*, 111 S. Ct. at 2456-2457 (O'Connor, J., dissenting). It also would impose very substantial administrative burdens, both on the states and on taxpayers. See *ATA*, 110 S. Ct. at 2333 (plurality opinion). In these circumstances, the almost incalculable disruption and confusion that would follow from extending backwards in time a decision overruling *ASARCO* and *Woolworth* would make retroactivity manifestly undesirable.

CONCLUSION

For more than a century, this Court has adhered to the bedrock principle that a state must have some concrete connection with out-of-state activities before it can exercise its tax power over such activities. A settled, workable, and substantially uniform system of state laws for taxing the income of multistate corporations evolved on the basis of that principle. No persuasive case has been made as to why this system should be abandoned and, as demonstrated above, the consequences of abandoning the system would be catastrophic. Moreover, if such a case had been made, a change of the magnitude that the Court is apparently contemplating is surely a matter that should be left to Congress. See Allied-Signal Rep. Br. 16-17.

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APPENDIX

APPENDIX

SITUS TO WHICH MULTISTATE CORPORATIONS MUST ASSIGN INCOME FROM INTANGIBLE PROPERTY WHEN IT IS DETERMINED TO BE ALLOCABLE FOR STATE TAX PURPOSES.[1]

STATE	SITUS OF ALLOCABLE INTANGIBLE INCOME[2]			CITATIONS
	INTEREST	DIVIDENDS	CAP. GAINS	
Alabama	CD	CD	CD	Ala. Admin. Code r. 810-3-31-.02(4)(b)(3), (c) (1988)
Alaska	CD	CD	CD	Alaska Stat. § 43.19.010, Art. IV, 6(c), 7 (1990)
Arizona	CD	CD	CD	Ariz. Rev. Stat. Ann. §§ 43-1136.C, -1137 (Supp. 1991)
Arkansas	CD	CD	CD	Ark. Code Ann. §§ 26-51-706(c), -707 (Michie 1987)
California	CD	CD	CD[3]	Cal. Rev. & Tax. Code §§ 25125(c), 25126 (West 1992)
Colorado	CD	CD	CD	Colo. Rev. Stat. Ann. § 24-60-1301, Art. IV, 6(c), 7 (West 1990)
Connecticut	n.a.	**	n.a.	Conn. Gen. Stat. Ann. § 12-218 (West Supp. 1991)

SITUS OF ALLOCABLE INTANGIBLE INCOME

STATE	INTEREST	DIVIDENDS	CAP. GAINS	CITATIONS
Delaware	where transaction took place	n.a.	n.a.	Del. Code Ann. tit. 30, § 1903(b) (1985)
Florida	CD	CD	CD	Fla. Stat. Ann. § 220.16(2)(c), (3) (West 1989)
Georgia	BS [4]	BS [4]	BS	Ga. Code Ann. § 48-7-31(c) (Supp. 1991)
Hawaii	CD	CD	CD [8]	Haw. Rev. Stat. §§ 235-26(c), -27 (1992)
Idaho	CD	CD	CD	Idaho Code § 63-3027(f)(3), (g) (1989)
Illinois	CD	CD	CD	Ill. Ann. Stat. ch. 120, ¶¶ 3-301(c)(2)(B), 3-303(b)(3) (Smith-Hurd 1991)
Indiana	CD	CD	CD	Ind. Code Ann. § 6-3-2-2(i)(3), (j) (West Supp. 1991)
Iowa	CD	CD	CD	Iowa Code Ann. § 422.33.2.a(1), (4) (West 1990)
Kansas	CD	CD	CD	Kan. Stat. Ann. §§ 79-3276(c), -3277 (1989)

Kentucky	CD	**	CD	Ky. Rev. Stat. Ann. § 141.120(5)(c), (6) (Michie/Bobbs-Merrill 1991)
Louisiana	BS/CD	BS/CD	BS/CD	La. Rev. Stat. Ann. § 47:287.93.A (West 1990)
Maine	n.a.	n.a.	n.a.	Me. Rev. Stat. Ann. tit. 36 § 5211 (West 1990 and Supp. 1991)
Maryland	n.a.	n.a.	n.a.	Md. Code Ann., Tax-Gen. § 10-402 (Supp. 1991)
Massachusetts	n.a.	n.a.	n.a.	Mass. Gen. Laws Ann. ch. 63, §§ 38, 38A, 42A (West 1988)
Michigan	*	*	*	Mich. Comp. Laws Ann. § 208.31 (West 1986 and Supp. 1991)
Minnesota	CD	CD	CD [3]	Minn. Stat. Ann. § 290.17.2 (West Supp. 1992)
Mississippi	CD	CD	BS/CD	Miss. Code Ann. § 27-7-23(c)(4) (1991)
Missouri	CD	CD	CD	Mo. Ann. Stat. § 32.200, Art. IV, ¶ 6(3), 7 (Vernon 1969)
Montana	CD	CD	CD	Mont. Code Ann. § 15-31-304(3)(c), (4) (1991)
Nebraska [5]	n.a.	n.a.	n.a.	Neb. Rev. Stat. § 77-2734.06 (1990)

STATE	SITUS OF ALLOCABLE INTANGIBLE INCOME			CITATIONS
	INTEREST	DIVIDENDS	CAP. GAINS	
Nevada	*	*	*	
New Hampshire	n.a.	n.a.	n.a.	N.H. Rev. Stat. Ann. § 77-A:3 (1991 and Supp. 1991)
New Jersey	n.a.	n.a.	n.a.	N.J. Stat. Ann. § 54:10A-6 (West 1986)
New Mexico	CD	CD	CD	N.M. Stat. Ann. § 7-4-7(c), -8 (Michie 1990)
New York [6]	n.a.	n.a.	n.a.	N.Y. Tax Law § 210 (McKinney 1986 and Supp. 1992)
North Carolina	CD	CD	CD	N.C. Gen. Stat. § 105-130.4(e)(3), (f) (1989)
North Dakota	CD	CD	CD	N.D. Cent. Code §§ 57-38.1-04, -06, -07 (1983 and Supp. 1991)
Ohio [7]	n.a.	n.a.	n.a.	Ohio Rev. Code Ann. § 5733.051(E), (F), (H) (Anderson 1991)
Oklahoma	BS/CD	BS/CD	BS/CD	Okla. Stat. Ann. tit. 68, § 2358.A.4.b (Supp. 1992)
Oregon	CD	CD	CD [8]	Or. Rev. Stat. § 314.635(3), .640 (1986 and Supp. 1990)

Pennsylvania	CD	**	CD	Pa. Stat. Ann. tit. 72, § 7401(3)(2)(a)(6)(C), (7) (1990)
Rhode Island	n.a.	n.a.	n.a.	R.I. Gen. Laws § 44-11-11, -14 (1988)
South Carolina	CD	CD	CD	S.C. Code Ann. § 12-7-1110, -1120(1), (2), (5) (Law. Co-op. 1976 and Supp. 1991)
South Dakota	CD	CD	CD	S.D. Codified Laws Ann. § 10-43-25.5 (1989)
Tennessee	CD	CD	CD	Tenn. Code Ann. § 67-4-810(c)(3), (d) (1989)
Texas	*	*	*	
Utah	CD	CD	CD	Utah Code Ann. §§ 59-7-308(3), -309 (1987)
Vermont	n.a.	n.a.	n.a.	Vt. Stat. Ann. tit. 32 § 5833 (1981 and Supp. 1991)
Virginia	n.a.	CD	n.a.	Va. Code Ann. § 58.1-407, -408 (Michie 1991)
Washington	*	*	*	
West Virginia	CD	CD	CD	W. Va. Code § 11-24-7(d)(2)(C), (3) (1991)
Wisconsin	n.a.	n.a.	n.a.	Wis. Stat. Ann. § 71.25(5)(a)(9), (10) (West 1984)
Wyoming	*	*	*	

LEGEND

CD = commercial domicile, *i.e.*, the principal place from which the trade or business of the taxpayer is directed or managed.

BS = business situs, which this Court has defined as the state in which "intangibles . . . are used in the business or are incidental to it, and have thus become 'integral parts of some local business.'" *First Bank Stock Corp. v. Minnesota*, 301 U.S. 234, 237 (1937).

BS/CD = the state allocates income to business situs or, if none, to commercial domicile.

n.a. = the state does not allocate that class of income.

* = the state does not subject corporations to a net income tax.

** = the state does not impose an income tax on dividends received by corporations. Conn. Gen. Stat. Ann. § 12-217(a) (West Supp. 1991); Ky. Rev. Stat. Ann. § 141.010(12)(b) (Michie/Bobbs-Merrill 1991); Pa. Stat. Ann. tit. 72, § 7401 (3)(1)(a), (b) (1990).

FOOTNOTES

[1] This chart includes state allocation rules for corporations generally, and not for special industries.

[2] In some states, a class of income may be either allocable or apportionable, depending on certain characteristics of the property or transaction and peculiarities of the state law. This chart shows the state to which income is assigned only when it is determined to be allocable in a state. Thus, for example, if a state allocates some dividends and apportions others, the chart would show the situs of the allocable dividends only.

[3] Gains and losses from the sale of partnership interests are allocable to the state in the ratio of the original cost of partnership tangible property in the state to the original cost of partnership tangible property everywhere, determined at the time of the sale. If more than 50 percent of the value of the partnership's assets consist of intangibles, gain or loss is allocated to the state in accordance with the sales factor of the partnership for its first full tax period immediately preceding the tax period of the partnership during which the partnership interest

was sold. Cal. Rev. and Tax. Code § 25125(d) (West 1992); Haw. Rev. Stat. §§ 235-26(d) (1992); Minn. Stat. Ann. § 290.17, subd. 2(c) (West Supp. 1992); Or. Rev. Stat. § 314.635(4) (1986 and Supp. 1990).

[4] Income received from intangible property held for investment (*i.e.*, interest and dividends) is allocated to the state if the situs of the corporation is in the state or if the intangible property was acquired as income from property held in the state or as a result of business done in the state. Ga. Code Ann. § 48-7-31(c)(1) (Supp. 1991). The "situs of the corporation" is its business situs. *Owens-Illinois Glass Co. v. Oxford*, 116 S.E.2d 293, 299 (Ga. 1960).

[5] All income is apportionable unless taxpayer proves (a) that the income is not part of a unitary business and (b) that the taxpayer has not claimed the income to be unitary in other states. In that case, the income is not taxed by Nebraska. Neb. Rev. Stat. § 77-2734.06(1) (1990).

[6] Certain dividends, interest, and capital gains (defined as "investment income") are apportioned on the basis of the payor's presence in the state. Other categories of dividends, interest, and capital gains are apportioned on the basis of the payee's factors in the state, while others are not taxed at all. N.Y. Tax Law §§ 208.9, 210 (McKinney 1986 and Supp. 1992).

[7] All interest, some dividends, and some capital gains from the sale of intangible propery, are apportioned on the basis of the payee's factors. Some dividends and gains from the disposition of certain dividend-yielding assets are apportioned on the basis of the payor's physical assets in the state. Ohio Rev. Code Ann. § 5733.051(E), (F), (H) (Anderson 1991).

(1)

No. 91-615

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL, INC., as successor-in-interest to The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari
To The Supreme Court
Of New Jersey

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QUESTIONS PRESENTED

1. Should the Court overrule *ASARCO Inc. v. Idaho State Tax Commission*, 458 *U.S.* 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 *U.S.* 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iv

SUMMARY OF ARGUMENT 1

ARGUMENT:

POINT I

ASARCO AND *WOOLWORTH* SHOULD BE OVERRULED BECAUSE THEY WERE BADLY REASONED, HAVE NO RELATION TO ECONOMIC REALITY, AND HAVE PRODUCED INCOHERENT, INCONSISTENT RESULTS IN THE LOWER COURTS 6

A. *ASARCO* and *Woolworth* Are Not Well Reasoned 7

B. *ASARCO* and *Woolworth* Have No Relation to Economic Reality 11

C. *ASARCO* and *Woolworth* Have Not Promoted Coherence in the Law 12

POINT II

IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE DECISION SHOULD HAVE RETROACTIVE EFFECT BECAUSE THE DECISIONS WERE NOT CLEAR PRECEDENTS ON WHICH BENDIX RELIED 15

A. Under the Various Opinions In *James Beam*, *ASARCO* and *Woolworth* Should Be Overruled Retroactively 15

B. *Chevron Oil* States the Appropriate Rule for Determining the Issue of Retroactive or Prospective Overruling 21

TABLE OF CONTENTS – Continued

Page

POINT III

IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE COURT SHOULD CONSTRUE THE DUE PROCESS CLAUSE TO PERMIT A NONDOMICILIARY STATE TO APPORTION ALL THE INCOME OF A SEPARATE MULTISTATE CORPORATE TAXPAYER, THEREBY ACHIEVING PREDICTABLE, FAIR, AND ECONOMICALLY REAL RESULTS 27

A. Nexus to Tax a Multistate Corporate Taxpayer Should Be Based on the Corporation's Presence within a Nondomiciliary State 27

B. The Proposed Rule Would Be Consistent with the Court's Prior Cases 30

C. Unitary Links Would Be Required to Combine Separate Corporate Entities 33

D. Fair Apportionment Would Continue To Be Tested under the Internal and External Consistency Tests 34

E. The Potential for Double Taxation Is Not a Constitutional Impediment 38

F. The Proposed Rule Would Permit State Law Variations 40

G. The Proposed Rule Would Be Predictable, Consistent with Economic Reality, and Fair 41

CONCLUSION 46

TABLE OF AUTHORITIES

Page

Cases Cited

Aero Mayflower Transit Co. v. Bd. of R.R. Comm'rs of Montana, 332 U.S. 495 (1947) 7

Aero Mayflower Transit Co. v. Georgia Public Service Comm'n, 295 U.S. 285 (1935) 7

Allen v. State Bd. of Elections, 393 U.S. 544 (1968) 23

Allied-Signal, Inc. v. Commissioner of Finance, 79 N.Y.S.2d 73 (N.Y. Ct. App. 1991) 41

Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. 66 (1989) 4, 32, 38

American Home Products Corp. v. Director, Div. of Taxation, 11 N.J. Tax 287 (Tax. Ct. 1990), *appeal pending*, N.J. Super. Ct., No. A-4316-90T3 13

American Oil Co. v. Neill, 380 U.S. 451 (1965) 28

American Trucking Associations, Inc. v. Scheiner, 483 U.S. 266 (1987) 2, 7, 25

American Trucking Ass'ns v. Smith, 110 S.Ct. 2323 (1990) ..... *passim*

Arkansas Best Corp. v. Commissioner, 485 U.S. 212 (1988) 6, 45

ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) ..... *passim*

Atlantic Richfield Co. v. Colorado, 198 Colo. 413, 413 P.2d 628 (1979) 14

Bass, Ratcliff & Gretton v. State Tax Comm'n, 266 U.S. 271 (1924) 18, 31

Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988) 21

Buckley v. Valeo, 424 U.S. 1 (1976) 23

TABLE OF AUTHORITIES – Continued

Page

Burlington Northern R. Co. v. Maintenance Way Employees, 481 U.S. 429 (1987) 23

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Butler Bros. v. McColgan, 315 U.S. 501 (1942) 31, 32

Capitol Greyhound Lines v. Brice, 339 U.S. 542 (1950) 7

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)..... *passim*

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Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) 7

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 2, 7, 26, 37

Container Corp. v. Franchise Tax Bd., 463 U.S. 159 (1983) ..... *passim*

Corn Products Refining Co. v. Comm'r, 350 U.S. 46 (1955) 44

Corning Glass Works, Inc. v. Virginia Dep't of Taxation, 402 S.E.2d 35 (Va. 1991), *cert. denied*, 112 S.Ct. 277 (1991)..... 13

Curry v. McCanless, 307 U.S. 357 (1939).....37, 40

Dennis v. Higgins, 111 S.Ct. 865 (1991)..... 26

Dep't of Revenue of Washington v. Ass'n of Washington Stevedoring Cos., 435 U.S. 734 (1978)..... 7

TABLE OF AUTHORITIES – Continued

Page

Douglass v. Pike County, 101 *U.S.* 677 (1880) 23

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Exxon Corp. v. Hunt, 109 *N.J.* 110, 534 *A.*2d 1 (1987), *on remand from* 475 *U.S.* 355 (1986) 25

Exxon Corp. v. Wisconsin Dep't of Revenue, 447 *U.S.* 207 (1980) 31

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F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 *U.S.* 354 (1982) ..... *passim*

Ford Motor Credit Co. v. Dep't of Revenue, 111 *S.Ct.* 2049 (1991), *aff'g* 537 *So.*2d 1011 (Fla. App. 1st Dist. 1988) 37

General Motors Corp. v. Washington, 377 *U.S.* 436 (1964) 7

Great Northern Railway Co. v. Sunburst Oil & Ref. Co., 287 *U.S.* 358 (1932) 24

Griffith v. Kentucky, 479 *U.S.* 314 (1987) 22

Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 *U.S.* 123 (1931) 31, 32

Heisler v. Thomas Colliery Co., 260 *U.S.* 245 (1922) 7

Honig v. Doe, 484 *U.S.* 305 (1988) 23

Int'l Harvester Co. v. Dep't of Treasury, 322 *U.S.* 340 (1944) 18, 28

TABLE OF AUTHORITIES – Continued

Page

Int'l Harvester Co. v. Wisconsin Dep't of Taxation, 322 U.S. 435 (1944) 29

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James v. Int'l Tel. & Tel. Corp., 654 S.W.2d 865 (Mo. 1983) 13

James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439 (1991) ..... *passim*

Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422 (1947) 7

Kaiser Aluminum v. Bonjorno, 110 S.Ct. 1570 (1990) 21

Lemon v. Kurtzman, 411 U.S. 192 (1973) 21, 25

Linkletter v. Walker, 381 U.S. 618 (1965) 21

Lone Star Steel Corp. v. Dolan, 668 P.2d 916 (Colo. 1983) 14

M. Lowenstein Corp. v. South Carolina Tax Comm'n, 298 S.C. 93, 378 S.E.2d 272 (1989) 14

McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco, Dept. of Business Regulation of Florida, 110 S.Ct. 2238 (1990) 22, 26

Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954) 1, 8, 28, 34

Mobil Oil Corp. v. Comm'n of Taxes, 445 U.S. 425 (1980) ..... *passim*

TABLE OF AUTHORITIES – Continued

Page

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Moorman Mfg. Co. v. Bair, 437 *U.S.* 267 (1978) ... *passim*

Nat'l Geographic Society v. California Bd. of Equalization, 430 *U.S.* 551 (1977) 8, 28

NCR Corp. v. Comptroller of the Treasury, 313 *Md.* 118, 554 *A.*2d 764 (1988) 14, 17

New York ex rel. Cohn v. Graves, 300 *U.S.* 308 (1937) 40

Norfolk and Western R. Co. v. Missouri Tax Comm'n, 390 *U.S.* 317 (1968) 31, 35

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Northwestern States Portland Cement Co. v. Minnesota, 358 *U.S.* 450 (1959) 15, 29, 30

Payne v. Tennessee, 111 *S.Ct.* 2597 (1991) 1, 6

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Qualls v. Montgomery Ward & Co., 266 *Ark.* 207, 585 *S.W.*2d 18 (1979) 14

Salorio v. Glaser, 93 *N.J.* 447, 461 *A.*2d 1100, *cert. denied*, 464 *U.S.* 993 (1983) 25

Shaffer v. Carter, 252 *U.S.* 37 (1940) 40

TABLE OF AUTHORITIES – Continued

Page

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Southern Pacific Co. v. Jensen, 244 U.S. 205 (1917) 22

Southern Pacific Terminal Co. v. I.C.C., 219 U.S. 498 (1911) 23

Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951) 7

State Bd. of Insurance v. Todd Shipyards Corp., 370 U.S. 451 (1962) 14

Super Valu Stores v. Iowa Dep't of Revenue and Finance, 479 N.W.2d 255 (Iowa 1991) 17

Trinova Corp. v. Michigan Dep't of Treasury, 111 S.Ct. 818 (1991) 2, 32, 42

Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue, 483 U.S. 232 (1987) 7

Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920) 31, 33

Union Pacific R.R. Co., Inc. v. United States, 524 F.2d 1343 (Ct. Cl. 1975) 45

United States Glue Co. v. Oak Creek, 247 U.S. 321 (1918) 30

Vasquez v. Hillery, 474 U.S. 254 (1986) 6

W.R. Grace & Co. v. Comm'r of Revenue, 378 Mass. 577, 393 N.E.2d 330 (1979) 13, 19

TABLE OF AUTHORITIES – Continued

Page

W.W. Windle Co. v. Commissioner, 65 *T.C.* 694 (1976), *appeal dismissed*, 550 *F.*2d 43 (1st Cir. 1977), *cert. denied*, 431 *U.S.* 966 (1977) 44

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Wheeling Steel Corp. v. Fox, 298 *U.S.* 193 (1936) 31

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APPENDIX

American Trucking Ass'n v. Kline, No. 07-14-1667-85 MVT (Sept. 8, 1988) 1a

Chart of published cases involving the inclusion of intangibles income in the preapportionment tax base 21a

SUMMARY OF ARGUMENT

Although we argued in our initial brief that the Court could decide this case in New Jersey's favor without overruling *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 *U.S.* 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 *U.S.* 354 (1982), if the Court wishes to clear up the confusion spawned by those decisions and establish a clear, sensible rule for the future, it should overrule them. *ASARCO* and *Woolworth* are weakly reasoned, inconsistent with common experience, and have proved to be unworkable in the lower courts. *Payne v. Tennessee*, 111 S.Ct. 2597 (1991).

The two decisions are weakly reasoned because they lose sight of what the Due Process Clause requires. As interpreted in *Miller Bros. Co. v. Maryland*, 347 *U.S.* 340, 344-45 (1954), the Clause requires that the person, property, or transaction that the state seeks to tax be within its borders. When a multistate corporation is doing business in the taxing state, that corporation is within the state's borders for tax purposes, *Mobil Oil Corp. v. Comm'r of Taxes*, 445 *U.S.* 425, 437 (1980), and when the income of a single corporation is the measure of the tax, the Due Process Clause does not require a nexus between the state and other taxpayers or other taxpayers' income. *Wisconsin v. J.C. Penney Co.*, 311 *U.S.* 435, 445 (1940). *ASARCO* and *Woolworth*, by requiring an operating relationship between the payor and payee of investment income, unjustifiably impose an extra nexus requirement – a connection with a separate taxpayer and its income. Neither the long line of cases testing state taxes under the Due Process Clause nor the unitary business cases preceding

and subsequent to *ASARCO* and *Woolworth* require such double nexus.

Further, as we suggested in our initial brief (Rb36), *ASARCO* and *Woolworth* have no relation to common experience, in particular, economic reality, a guideline in the state taxation field that the Court has recognized since its decision in *Complete Auto Transit, Inc. v. Brady*, 430 *U.S.* 274 (1977); *Trinova Corp. v. Michigan Dep't of Treasury*, 111 *S.Ct.* 818, 828 (1991). Corporate investing is on a continuum. The line between operational and passive intangibles cannot be drawn with precision. Neither the accounting profession nor the business community can say with certitude where one leaves off and the other begins.

Moreover, *ASARCO* and *Woolworth* have spawned continuing litigation and incoherent, inconsistent results as lower courts search for operating relationships between payor and payee when they think the facts are similar to those in *ASARCO* and *Woolworth*, but look for the integration of an investment with the taxpayer's operations when dealing with short-term investments.

If *ASARCO* and *Woolworth* are overruled, the decision should be retroactive under *Chevron Oil Co. v. Huson*, 404 *U.S.* 97 (1971). While all the views espoused in *James B. Beam Distilling Co. v. Georgia*, 111 *S.Ct.* 2439 (1991), and in *American Trucking Ass'ns v. Smith*, 110 *S.Ct.* 2323 (1990), point to retroactive overruling here, we believe that the *Chevron Oil* test is the appropriate one because it allows for purely prospective overruling in exceptional cases to protect the reliance interests of those affected by the overruling decision.

In this case, petitioner cannot meet *Chevron Oil*'s three-part test for prospective overruling. First, the overruling of *ASARCO* and *Woolworth* would not establish a new principle of law within the meaning of *Chevron Oil*. *ASARCO* and *Woolworth* were never the kind of "clear precedent" that *Chevron Oil* contemplates, and, once the Court decided *Container Corp. v. Franchise Tax Bd.*, 463 *U.S.* 159 (1983), the precedent established by those decisions was even less clear. Moreover, Bendix cannot have relied on the two decisions when it sold its stock in ASARCO because the stock sale took place before the decisions were issued. Second, prospective application would not further the new rule (assuming there were one) because, despite a more relaxed nexus standard, New Jersey would be exposed to a substantial loss of tax revenue in pending assessment and refund cases and additional refund claims. Third, the equities do not favor prospective overruling. Bendix should have known that *ASARCO* and *Woolworth* were suspect as soon as the Court issued its decision in *Container*, 463 *U.S.* 159 (1983), because the Court made clear in that case that the factors deemed essential in *ASARCO* and *Woolworth* to the existence of a unitary business – operating control and substantial flows of product – were not required after all. *Container*, 463 *U.S.* at 178-179.

If *ASARCO* and *Woolworth* are overruled, the Court should construe the Due Process Clause to permit a nondomiciliary state to tax on an apportioned basis all the net income of a single corporate entity doing business within its borders. Nexus would be established by the corporation's presence in the taxing state. *Mobil*, 445 *U.S.* at 437. Since only that corporation would be subjected to

tax and only that corporation's income would be included in the tax base, there would be no requirement of a separate nexus with particular streams of income or with other taxpayers.

On the other hand, where, as in a combined report, income of separate corporations is included in the tax base and the taxing state has no necessary contact with those other corporations, the Court should construe the Clause to require a nexus with the separate streams of income. This nexus would be formed by unitary links between the separate corporate entities as described in *Container, Id.*

The proposed principle would not require the overruling of the Court's unitary business cases preceding or subsequent to *ASARCO* and *Woolworth* and would permit variations in states that do not choose to extend their taxing power as far as the proposed principle would allow. None of the Court's earlier unitary business cases posited an exclusive test of operating relationships between payor and payee, and cases subsequent to *ASARCO* and *Woolworth* have confirmed the impossibility of segregating from the unitary business particular streams of income and site-specific costs. *See e.g., Amerada Hess Corp. v. Director, Div. of Taxation*, 490 *U.S.* 66 (1989). A rule permitting less expansive interpretations of the Due Process Clause would be consistent with the Court's repeated admonition that it will not impose a single, uniform apportionment rule on the states, *Moorman Mfg. Co. v. Bair*, 437 *U.S.* 267, 279 (1978), and with its recognition in *Container* that the unitary business principle is not itself unitary. *Container*, 463 *U.S.* at 167. Thus, the states that distinguish between apportionable business income

and allocable nonbusiness income could continue to operate under their present statutory schemes.

Division of the tax base would continue to be tested under the fair relation requirement of the Due Process Clause and the fair apportionment standard of the Commerce Clause. *Container*, 463 *U.S.* at 169. In making that determination, the guiding principle should be the economic reality and practical effect of the tax in relation to the manner in which a multistate corporation is taxed throughout the Nation. A determination whether the apportionment formula should be adjusted on account of the inclusion of intangible income in the base should await the development of an adequate record. That record does not exist here because Bendix presented no facts below to suggest that the apportionment formula operated unfairly and has conceded the issue in this Court.

While inclusion of investment income in the preapportionment tax base would increase the risk of double taxation, that risk exists in the present system and is constitutionally acceptable under *Moorman*, *Mobil* and *Container*. In order to prohibit double taxation, the Court would have to determine which of two states' taxing schemes should take precedence, a course it has not pursued when each state has a legitimate claim to tax a share of a multistate taxpayer's income. *Mobil*, 445 *U.S.* at 446.

The proposed principle would be clear and predictable and thus easy for lower courts to apply, consistent with economic reality, and not subject to manipulation. *See Arkansas Best Corp. v. Commissioner*, 485 *U.S.* 212, 222-23 (1988).

ARGUMENT

POINT I

ASARCO AND *WOOLWORTH* SHOULD BE OVERRULED BECAUSE THEY WERE BADLY REASONED, HAVE NO RELATION TO ECONOMIC REALITY, AND HAVE PRODUCED INCOHERENT, INCONSISTENT RESULTS IN THE LOWER COURTS.

Stare decisis is often preferred because it furthers predictability and confidence in the judicial system. *Payne v. Tennessee*, 111 *S.Ct.* at 2609 (1991). It is not, however, an "inexorable command," giving way to "the lessons of experience and the force of better reasoning . . . " *Burnet v. Coronado Oil & Gas Co.*, 285 *U.S.* 393, 405, 407-08 (1932) (Brandeis, J., dissenting). Particularly in constitutional cases, "where correction through legislative action is practically impossible, this Court has often overruled its earlier decisions." *Id.* at 407; *Payne*, 111 *S.Ct.* at 2610. Whether framed in terms of a conviction that the prior decision "is egregiously wrong," *Payne*, 111 *S.Ct.* at 2613 (Scalia, J., concurring), "special justification," *id.* at 2618 (Souter, J., concurring) or "articulable reasons," *Vasquez v. Hillery*, 474 *U.S.* 254, 266 (1986), the factors included in a decision to overrule include "the need 'to bring [a decision] into agreement with experience and with facts newly ascertained,' . . . a showing that a particular precedent has become a 'detriment to coherence and consistency in the law,' " *Payne*, 111 *S.Ct.* at 2621-22 (Marshall, J., dissenting), and the perception that a prior precedent is unworkable or badly reasoned. *Id.* at 2609. When such

conditions coalesce, the Court has not hesitated to overrule its prior decisions.[1]

A. *ASARCO* and *Woolworth* Are Not Well Reasoned.

ASARCO and *Woolworth* are clear candidates for overruling. To begin with, they are poorly reasoned. As pointed out in New Jersey's initial brief (Rb45-46), *ASARCO*'s requirement of an operational link between the payor and payee of investment income makes no sense because the tax is being imposed on the payee's investment income in the hands of the payee. What the payor does and how it is related in an operational sense to the payee has no necessary relevance.

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[1] In the state tax area, the Court has overruled at least 8 of its Commerce Clause decisions over the last 15 years. *Complete Auto Transit v. Brady*, 430 *U.S.* 274 (1977) (overruling under the Commerce Clause *Spector Motor Service, Inc. v. O'Connor*, 340 *U.S.* 602 (1951)); *Dep't of Revenue of Washington v. Ass'n of Washington Stevedoring Cos.*, 435 *U.S.* 734 (1978) (overruling under the Commerce Clause *Puget Sound Stevedoring Co. v. Tax Comm'n of Washington*, 302 *U.S.* 90 (1937) and *Joseph v. Carter & Weekes Stevedoring Co.*, 330 *U.S.* 422 (1947)); *Commonwealth Edison Co. v. Montana*, 453 *U.S.* 609 (1981) (overruling under the Commerce Clause *Heisler v. Thomas Colliery Co.*, 260 *U.S.* 245 (1922); *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 483 *U.S.* 232 (1987) (overruling under the Commerce Clause *General Motors Corp. v. Washington*, 377 *U.S.* 436 (1964)); *American Trucking Ass'ns, Inc. v. Scheiner*, 483 *U.S.* 266 (1987) (in large part overruling under the Commerce Clause *Aero Mayflower Transit Co. v. Georgia Public Service Comm'n*, 295 *U.S.* 285 (1935), *Aero Mayflower Transit Co. v. Bd. of R.R. Comm'rs of Montana*, 332 *U.S.* 495 (1947), and *Capitol Greyhound Lines v. Brice*, 339 *U.S.* 542 (1950)).

The Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros.*, 347 *U.S.* at 344-45. In the case of a multistate corporation, there must be a minimal connection between its interstate activities and the taxing state. *Moorman*, 437 *U.S.* at 272-73. The doctrinal error of *ASARCO* and *Woolworth* is to require a double nexus – a connection between the multistate corporation's activities and the taxing state and a further connection between "the activities of the dividend payor" and the taxing state. *ASARCO*, 458 *U.S.* at 327. Neither traditional Due Process Clause analysis nor the Court's unitary business cases have required such double nexus.[2] A state's justification to tax the recipient

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[2] *See e.g., Wisconsin v. J.C. Penney Co.*, 311 *U.S.* 435 (1940) (where tax was for privilege of carrying on business in Wisconsin, nexus was created by foreign corporation's activities in the state; fact that transaction which triggered the tax (declaration of a dividend) occurred outside Wisconsin was immaterial); *Int'l Harvester Co. v. Dep't of Treasury*, 322 *U.S.* 340 (1944) (where sales took place within taxing state and tax was measured by sales income, fact that corporate seller was based out-of-state and contracts were made out-of-state was not controlling; taxing state had jurisdiction over transaction being taxed); *Nat'l Geographic Society v. California Bd. of Equalization*, 430 *U.S.* 551, 561 (1977) (jurisdiction over the person of an out-of-state seller through its two in-state offices permitted state to require collection of its use tax despite absence of contact between in-state offices and sales in question); *Bass, Ratcliff & Gretton v. State Tax Comm'n*, 266 *U.S.* 271 (1924) (taxpayer's presence in taxing state, combined with taxpayer's unitary character, permitted inclusion of foreign source income in tax base despite federal tax loss); *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 *U.S.* 207, 221-23 (1980) (ability to source exploration,

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of income from intangibles lies in the protections and benefits it has extended to the recipient's activities within the taxing state. *J.C. Penney Co.*, 311 *U.S.* at 439. There is no basis in the Court's prior cases and no basis in logic for requiring a taxing state to extend protections and benefits to the payor of investment income when the state is not attempting to tax the payor. *Cf. ASARCO*, 458 *U.S.* at 327. In short, *ASARCO* and *Woolworth* fail to recognize who and what is being taxed.

Petitioner asserts in its initial reply brief (Prb10-11) that the *ASARCO/Woolworth* payor-payee test is grounded in the Court's cases holding that there must be a "substantial connection between income generated from out-of-state activities and the taxpayer's operations in the state" in order to establish that the state has " 'given anything for which it can ask return.' *Wisconsin v. J.C. Penney Co.*, 311 *U.S.* 435, 444 (1944)." Like the Court in *ASARCO*, petitioner confuses the issue of who and what is being taxed. Again, New Jersey is not attempting to tax ASARCO's income, and indeed the capital gains at issue were never ASARCO's income to begin with. Rather, New Jersey is taxing Bendix' income from the sale of the ASARCO stock. The question is therefore whether Bendix' investment activities outside New Jersey added

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production and refining income to locations outside taxing state did not prevent apportioned taxation of total unitary income). Application of the unitary business principle to separate corporations filing a combined report confirms this theory of the Due Process Clause. *See* Point III, *infra* at 33.

to the value of Bendix' unitary business, part of which was conducted in New Jersey.

Petitioner's suggestion to the contrary, neither *Wallace v. Hines*, 253 *U.S.* 66, 69-70 (1920), nor *Mobil* supports *ASARCO*. In *Wallace v. Hines*, the Court held that a railroad's out-of-state property did not "in some plain and fairly intelligible way" affect the in-state value of the road and could therefore not be included in apportioning for purposes of a property tax, the railroad's total property to the taxing state. As the Court made clear in *Container*, 463 *U.S.* at 188, property taxes and income taxes differ. As tangible property can be seen and attributed to a particular situs, *Mobil*, 445 *U.S.* at 445, it is possible to determine with greater certainty whether discrete out-of-state properties contribute to in-state values. In the case of an income tax, there is no basis for rejecting formulary apportionment where discrete out-of-state activities cannot be directly linked to activities within the taxing state provided both sets of activities are parts of a single business. The "plain and intelligible" relationship in the case of an income tax may be forged through centralized management or a corporate strategy that links both sets of activities.

Similarly, *Mobil* does not support the *ASARCO/Woolworth* payor-payee test. The Court in *Mobil* states that, in order to avoid Vermont's tax, Mobil would have to establish that the dividend income which Vermont sought to tax was income "earned in the course of activities unrelated to the sale of petroleum products in that State." 445 *U.S.* at 439. Petitioner reads this to refer to the operating income earned by Mobil's subsidiaries, but the statement refers equally to Mobil's management of its subsidiaries

as the source of the dividend income in Mobil's hands. In short, the Court's earlier cases do not lay the groundwork for the *ASARCO/Woolworth* payor-payee rule.[3]

B. *ASARCO* and *Woolworth* Have No Relation to Economic Reality.

Not only are *ASARCO* and *Woolworth* poorly reasoned, they are inconsistent with economic reality. Once it is conceded that income earned on the short term investment of working capital is apportionable without regard to an operating relationship between the recipient and the payor, *ASARCO*, 458 *U.S.* at 337-38 (O'Connor, J., dissenting), there is no rationally determinable point at which the unitary business analysis should shift from the integration of an investment with the operations of the taxpayer to the *ASARCO/Woolworth* test of operating relationships between payor and payee. Moreover, any attempt to distinguish between investments that are integrated with a taxpayer's business and those that are not leads inevitably to the kind of arbitrary distinctions that the Court criticized in *ASARCO*, 458 *U.S.* at 326.

Bendix' analysis of the ASARCO investment, as discussed in our initial brief (Rb36) and as evident in the record, underscores the divergence between the

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[3] Commentators have criticized the *ASARCO* and *Woolworth* opinions. *See* New Jersey's initial brief at 39, n. 21. *See also* Greene, "*ASARCO* and *Woolworth*: Anomalous Anachronisms With Limited Precedential Value," *Tax Notes* 795 (March 7, 1983).

ASARCO/Woolworth payor-payee test and economic reality. In his memorandum to the long range planning committee of the Bendix Board, William Agee states that, "Blackie [the code name for ASARCO] is a firm which nearly matches the qualities we seek" and then continues:

> Particular attention should be paid to Blackie's product diversification particularly in silver, zinc, asbestos, lead, coal and other profitable minerals and to its rich holdings in the M.I.M. Holdings (Mt. Isa project) in Australia reported to be one of the largest mining operations in the world. Allegedly, Blackie's holdings in this project at market value exceed the market value of Blackie's own equities [J.A. 101-102].

While viewed by Bendix' management as one of the most significant of ASARCO's holdings, the Court concluded in *ASARCO* that ASARCO's dividends from M.I.M. were not apportionable because M.I.M. operated independently from ASARCO and any business relationship between the two companies was "nominal." *ASARCO*, 458 *U.S.* at 323.

C. *ASARCO* and *Woolworth* Have Not Promoted Coherence in the Law.

ASARCO and *Woolworth* have spawned continuing litigation and inconsistent, incoherent results in the lower courts.[4] In Missouri and Virginia a capital gain received

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[4] Included in the appendix to this brief is a list of published cases involving the inclusion of intangibles income in the preapportionment tax base (Rsa 21a-25a).

One need look no further than Volume 11 of the New Jersey Tax Court Reports to see the difficulty the lower courts

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on the divestiture of a corporate affiliate is nonunitary income where there is no operating relationship between the stock issuer and recipient of the gain despite facts showing a corporate strategy of buying and selling control or minority interests in other corporations. *See James v. Int'l Tel. & Tel. Corp.*, 654 *S.W.*2d 865 (Mo. 1983); *Corning Glass Works, Inc. v. Virginia Dep't of Taxation*, 402 *S.E.*2d 35 (Va. 1991), *cert. denied*, 112 *S.Ct.* 277 (1991). In New Jersey such gains would likely be apportionable under the New Jersey Supreme Court's decision in this case. In Massachusetts and Colorado the result would be similar to that in New Jersey although the decisions in those states predate *ASARCO* and *Woolworth*. *W.R. Grace & Co. v. Comm'r of Revenue*, 378 *Mass.* 577, 393 *N.E.*2d 330 (1979);

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face in trying to apply the *ASARCO/Woolworth* payor-payee test in a coherent fashion. In this case the New Jersey Tax Court distinguished *ASARCO* and *Woolworth* and relied on the New Jersey Supreme Court's decision in *Silent Hoist & Crane Co., Inc. v. Director, Div. of Taxation*, 100 *N.J.* 1, 494 *A.*2d 775, *cert. denied*, 474 *U.S.* 995 (1985) (Pet. App. C at 45a). In *Int'l Paper Co. v. Director, Div. of Taxation*, 11 *N.J. Tax* 147, 163 (Tax Ct. 1990 en banc), *aff'd*, N.J. Super. Ct., No. A-5138-89T5 (May 13, 1991), *certif. den.*, N.J. Sup. Ct., No. 33,784 (Oct. 16, 1991), the same court reasoned in part that, "[t]he facts of the subject case are more like the facts of *ASARCO* and *Woolworth* than those of *Silent Hoist*, and therefore *ASARCO* and *Woolworth* govern the subject case . . . . " In *American Home Products Corp. v. Director, Div. of Taxation*, 11 *N.J. Tax* 287 (Tax Ct. 1990), appeal pending, N.J. Super. Ct., No. A-4316-90T3, the court analyzed American Home's short-term investments from the point of view of the relationships between the investments and American Home's business, 11 *N.J. Tax* at 303-09, but analyzed American Home's minority stock investments from the point of view of operating relationships between the issuers and American Home. *Id.* at 300-03.

Atlantic Richfield Co. v. Colorado, 198 *Colo.* 413, 601 *P.*2d 628 (1979).

ASARCO and *Woolworth* have produced similar, inconsistent results in the treatment of interest on loans between corporate affiliates. In Arkansas, as the result of the overruling of *Qualls v. Montgomery Ward & Co.*, 266 *Ark.* 207, 585 *S.W.*2d 18 (1979), in *Pledger v. Illinois Tool Works*, 306 *Ark.* 134, 812 *S.W.*2d 101, *cert. denied*, 112 *S.Ct.* 418 (1991), interest on loans to corporate affiliates is not apportionable business income even though the loans are made in the regular course of the lending corporation's business. In South Carolina, Maryland, and Colorado interest on loans to a corporate affiliate is apportionable. *M. Lowenstein Corp. v. South Carolina Tax Comm'n*, 298 *S.C.* 93, 378 *S.E.*2d 272 (1989); *NCR Corp. v. Comptroller of the Treasury*, 313 *Md.* 118, 554 *A.*2d 764 (1988); *Lone Star Steel Corp. v. Dolan*, 668 *P.*2d 916 (Colo. 1983).

Amicus curiae, the Committee on State Taxation, has suggested that *stare decisis* should be given particular weight in the commercial arena and that *ASARCO* and *Woolworth* should therefore not be overruled (COSTb 8). But the fact that business taxpayers and the expectations of those taxpayers are involved has never been a deterrent to the Court's overruling of its prior precedents in the state tax area. *See supra* note 1.

Nor does the possibility that Congress might act under the Commerce Clause suggest a basis for not overruling *ASARCO* and *Woolworth* (Prb16). There is doubt whether Congress could curtail taxpayers' rights under the Due Process Clause as guaranteed by *ASARCO* and *Woolworth*. *ASARCO*, 458 *U.S.* at 350 (O'Connor, J., dissenting); *State Board of Insurance v. Todd Shipyards Corp.*,

370 *U.S.* 451, 457 (1962) ("Congress, of course, does not have the final say as to what constitutes due process under the Fourteenth Amendment"). Moreover, history demonstrates that Congress has legislated infrequently in the state tax area.[5] Furthermore, as demonstrated above at note 1, this Court has not hesitated in the past to overrule prior decisions that Congress could have undertaken to change.

Point II

IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE DECISION SHOULD HAVE RETROACTIVE EFFECT BECAUSE THE DECISIONS WERE NOT CLEAR PRECEDENTS ON WHICH BENDIX RELIED.

A. Under the Various Opinions in *James Beam*, *ASARCO* and *Woolworth* Should Be Overruled Retroactively.

Resolution of the issue of retroactive or prospective overruling is not difficult here. Under any of the views espoused in *Beam* and *Smith*, a decision to overrule *ASARCO* and *Woolworth* should have retroactive effect.

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[5] Over the last 50 years, the only congressional enactment affecting the broad spectrum of multistate businesses is *P.L.* 86-272, 73 *Stat.* 555, 15 *U.S.C.* §381, which restricts the power of a state to impose a tax on or measured by net income if the only in-state activity of an out-of-state corporation is the solicitation of orders for sales of tangible personal property where the orders are accepted, filled, and shipped from points outside the taxing state. *P.L.* 86-272 was enacted in response to this Court's decision in *Northwestern States Portland Cement Co. v. Minnesota*, 358 *U.S.* 450 (1959). *See* J. Hellerstein and W. Hellerstein, *State and Local Taxation*, 326-27, 333-34, 387-89, 1004-07 (5th ed. 1988).

Under the plurality opinion in *Beam*, if an overruling decision fails to reserve the issue of retroactive or prospective effect, the usual rule of full retroactivity must be deemed to apply to the parties. *Beam*, 111 *S.Ct.* at 2445. Under this approach, unless the Court specifically holds that its decision to overrule *ASARCO* and *Woolworth* will be prospective or unless it remands to the New Jersey courts to consider the issue, its decision will be retroactive and will apply to all cases currently pending at the administrative or judicial level as well as to all cases where the New Jersey Division of Taxation may issue deficiency assessments under the applicable statute of limitations on assessment.[6] *Beam*, 111 *S.Ct.* at 2448. There is no immediate issue of selective prospectivity in a case like this where the choice of law issue is resolved in the overruling decision itself. *Cf. Beam*, 111 *S.Ct.* at 2445-46.

Under the concurring opinions of Justices Blackmun and Scalia in *Beam* and Justice Stevens in *Smith*, there is no choice to make: All overruling decisions are invariably fully retroactive.

Under the plurality opinion in *Smith* and the dissenting opinion in *Beam*, an overruling decision may be retroactive or prospective depending upon consideration of

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[6] The period is generally five years under the Corporation Business Tax Act. *N.J.Stat.Ann.* §54:10A-19.1(b) (West 1986) ("N.J.S.A."). Since New Jersey has issued assessments against all taxpayers who have failed to include intangibles income in the preapportionment tax base, full retroactivity as to all assessments "not barred by procedural requirements," *Beam*, 111 *S.Ct.* at 2448, is congruent in this State with a more limited retroactive reach to all contested administrative or judicial proceedings.

the three factors discussed in *Chevron Oil*. *Beam*, 111 *S.Ct.* at 2451-56 (O'Connor, J., dissenting); *Smith*, 110 *S.Ct.* at 2331. Under the *Chevron Oil* test, an overruling decision will be given prospective effect (1) if it establishes "a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed," *Chevron*, 404 *U.S.* at 106, (2) if prospective application will further the new rule, and (3) if retroactive application "could produce substantial inequitable results . . . " *Id.* at 107. Application of the *Chevron Oil* test leads equally to the retroactive overruling of *ASARCO* and *Woolworth*.

Petitioner cannot meet the first test under *Chevron Oil* because *ASARCO* and *Woolworth* were not "clear past precedent," and, in any event, Bendix did not rely on them. As suggested by the continuing litigation in the lower courts (Rsa 21a-25a, and see *supra* note 4, *ASARCO* and *Woolworth* were not clear. Some courts saw them as limited to dividends from controlled subsidiaries. *Silent Hoist*, 100 *N.J.* at 19, 494 *A.*2d at 783; *NCR Corp.*, 313 *Md.* at 135, 544 *A.*2d at 772. Others apparently concluded that they did not apply when the tax was on separate corporate entities. *NCR Corp. v. Comm'r of Revenue*, 438 *N.W.*2d 86 (Minn. 1989), *cert. denied*, 493 *U.S.* 845 (1990). Still other courts applied *ASARCO* and *Woolworth* but ignored the requirement of substantial operating links, relying instead on administrative and financial connections. *Super Valu Stores v. Iowa Dep't of Revenue and Finance*, 479 *N.W.*2d 255 (Iowa 1991). Still others followed them to the point of overruling their prior decisions. *Pledger*, *supra*. Moreover, when the Court issued its opinion in *Container*

scarcely one year after *ASARCO* and *Woolworth* came down, it was readily apparent that the two decisions were on shaky ground. In *Container*, the Court made clear that actual, active control and a "substantial flow of goods" are not the sole criteria for a unitary business. *Container*, 463 *U.S.* at 177-79.[7]

Moreover, Bendix could not have relied on *ASARCO* and *Woolworth* when it engaged in the conduct that gave rise to the ASARCO gain. The Bendix Board authorized the sale of the ASARCO stock on October 7, 1980 (J.A. 171, ¶63), and the sale was completed during the first half of 1981 (J.A. 172, ¶67). As Bendix' sale of the ASARCO stock preceded the Court's June 29, 1982 decisions in *ASARCO* and *Woolworth*, Bendix plainly did not rely on those opinions when it decided to sell the stock and structured the transaction.[8] *Beam*, 111 *S.Ct.* at 2455. The fact that Bendix filed its 1981 return on July 15, 1982 (record at 231A), approximately two weeks after

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[7] Scholarly commentary has not failed to recognize *Container*'s shift in approach to the unitary business determination. *See* J. Hellerstein, *State Taxation I Corporate Income and Franchise Taxes*, S197 (1989 Cum. Supp.): "In *Container* . . . the Court. . . appears to have adopted the same type of non-intervention principle with respect to the definition of a unitary business that it had enunciated in the *Moorman* case with respect to challenges to the unfairness of a State apportionment formula."

[8] Additionally, Bendix paid its 1981 corporation business tax liability before *ASARCO* and *Woolworth* came down. On January 15, 1982, Bendix paid the amount it estimated would be due for its 1981 fiscal year, *viz.* $3 million (record at 240A), an amount which included the tax on the ASARCO gain.

ASARCO and *Woolworth* were issued and claimed a refund based on the two decisions (J.A. 206, 200), does not establish reliance on the *ASARCO/Woolworth* rule because " 'the underlying transaction' " occurred prior to the two decisions. *See Smith*, 110 *S.Ct.* 2335-36. On the contrary, at the time that Bendix sold the *ASARCO* stock, it was clear under New Jersey law that a corporate taxpayer was required to pay tax on an apportioned share of its "entire net income."[9] *F.W. Woolworth Co. v. Director, Div. of Taxation*, 45 *N.J.* 466, 213 *A.*2d.1 (1965).

Under the second and third *Chevron Oil* tests – whether the new rule will be furthered by retroactive or prospective overruling and whether the equities favor retroactive or prospective overruling – retroactive overruling of *ASARCO* and *Woolworth* is equally appropriate. In pending cases, the unitary business issue in New Jersey currently implicates approximately $34.6 million in state revenue.[10] The potential annual refund exposure is a

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[9] Under *N.J.S.A.* 54:10A-4(k) "entire net income" is defined as federal taxable income before the net operating loss deduction and special deductions. While dividends received from other corporations are wholly or partially excluded, *N.J.S.A.* 54:10A-4(k)(5), no exclusion applies to capital gains or interest income.

[10] This figure includes a total of approximately $19.3 million in assessments and $4.1 million in refund claims at the administrative level and $4.7 milion in assessments and $6.5 million in refunds in pending court actions. Most of the court cases involve pre-*ASARCO/Woolworth* tax years, while the agency proceedings involve post-*ASARCO/Woolworth* tax years. *See* Rsa 24a-25a.

maximum of roughly $110 million.[11] It would not further the new rule of law if New Jersey were to prevail but at the same time forfeit the revenue riding on the pending cases.[12] Petitioner, on the other hand, has no vested right in a refund to which it is not entitled under the Due Process Clause. From an equitable stand point, New Jersey acted in accordance with the correct rule and should not be penalized for having done so, while petitioner cannot claim reliance on *ASARCO* and *Woolworth* once *Container* was decided and in fact did not rely on the two decisions.[13]

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[11] The New Jersey statute of limitations for filing claims for refund is generally two years. *N.J.S.A.* 54:49-14. Some portion of the $110 million would be subject to the CBT under the *ASARCO/Woolworth* payor-payee test.

[12] Petitioner may contend that New Jersey deserves to forfeit these revenues for ignoring the Court's decisions in *ASARCO* and *Woolworth*. To the contrary, the New Jersey courts considered those cases and attempted to deal with them on a principled basis. See *supra* note 4 and *Mobil Oil Corp. v. Director, Div. of Taxation*, 11 *N.J. Tax* 344 (Tax Ct. 1990), *aff'd*, per curiam N.J. Super. Ct. No. A-2326-90T5 (March 4, 1992).

[13] The unsettled state of the law throughout the country suggests that the retroactive overruling of *ASARCO* and *Woolworth* would be an acceptable result in states other than New Jersey. Moreover, multistate taxpayers would receive some protection through the applicable statutes of limitation on assessment and from the statutory distinction in the 27 UDITPA states (and the seven additional states that follow UDITPA) between business and nonbusiness income.

B. *Chevron Oil* States the Appropriate Rule for Determining the Issue of Retroactive or Prospective Overruling.

While all the opinions in *Beam* and *Smith* point to retroactive overruling here, it seems to us that the *Chevron Oil* rule is the preferable one. Prosepctive overruling needs to be retained in order to reconcile a new constitutional rule "with reliance interests founded upon the old," interests that cannot be accommodated through an invariable rule of " 'absolute retroactive invalidity . . . ' " *Lemon v. Krutzman*, 411 *U.S.* 192, 198-99 (1973) (plurality opinion), quoting *Linkletter v. Walker*, 381 *U.S.* 618, 627 (1965).

The ability, on rare occasions, to overrule prospectively answers to the same concern that prompts a reluctance to condone retroactive statutory enactments and administrative rules. *Bowen v. Georgetown University Hospital*, 488 *U.S.* 204, 208 (1988). Absent clear language mandating retroactive application, prospectivity is favored to avoid unreasonably harsh results. *Id.*; *Kaiser Aluminum v. Bonjorno*, 110 *S.Ct.* 1570, (1990) (retroactive application of newly enacted statute "is contrary to fundamental notions of justice . . . ") (Scalia, J., concurring). While adjudication generally operates with retroactive effect, *Bowen*, 488 *U.S.* at 221 (Scalia, J. concurring), the concern for upsetting reasonable reliance on past statutory law that informs the prospective application of statutes, should, in exceptional cases, apply equally to judge-made law.

Purely prospective overruling does not violate "the principle of treating similarly situated defendants the

same." *Beam*, 111 *S.Ct.* at 2450 (Blackmun, J., concurring). As the decision is effective as to everyone in the future and as to no one retroactively, the concerns that prompted the decision in *Griffith v. Kentucky*, 479 *U.S.* 314 (1987), in the criminal law context are not present in the case of purely prospective overruling. More fundamentally, it is questionable that states and taxpayers throughout the country are necessarily "similarly situated" to the parties before the Court in a state tax case. *Smith*, 110 *S.Ct.* at 2342 (plurality opinion). Reliance interests may vary from state to state. Thus, selective prospectivity should be retained under *Chevron Oil*. This is particularly so in the state Tax area where it is uncertain after *McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco, Dep't of Business Regulation of Florida*, 110 *S.Ct.* 2238, 2254-56 (1990), that the equities in a particular case play more than a minor role in determining an appropriate remedy. *Smith*, 110 *S.Ct.* at 2332 (plurality opinion); *cf. Beam*, 111 *S.Ct.* at 2447-48 (plurality opinion).

While purely prospective overruling may raise a case or controversy issue under Article III, *Beam*, 111 *S.Ct.* at 2449 (Blackmun, J., concurring), at least in the context of a state tax, the concern seems more theoretical than real. The parties before the Court clearly have a live controversy on the merits – the constitutional validity of the tax. Due to the recurring nature of that controversy, its resolution has a direct effect on the parties even if the decision is purely prospective; either the state tax is effectively enjoined, *see Smith*, 110 *S.Ct.* at 2342, or it is validated and permits assessments for periods beginning on the date of the decision. As purely prospective overruling does affect the parties before the Court, at least in the context of state

taxes, it would not seem to threaten the integrity of judicial review. *Cf. Beam*, 111 S.Ct. at 2450 (Blackmun, J., concurring).[14]

Prospective overruling may indeed be legislative in nature, *Beam*, 111 *S.Ct.* at 2450-51 (Scalia, J., concurring), but common law judges have historically been viewed as "legislating" in a restricted, judicial manner. *Southern Pacific Co. v. Jensen*, 244 *U.S.* 205, 221 (1917) (Holmes, J., dissenting); O.W. Holmes, *The Common Law*, 35-36 (1881); B. Cardozo, *The Nature of the Judicial Process*, 113-17 (1921).

> [The judge] legislates only between gaps. He fills the open spaces in the law. . . . None the less, within the confines of these open spaces and those of precedent and tradition, choice

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[14] Other recurring controversies between governments and citizens where prospective overruling of state or local law has been deemed appropriate, include challenges to municipal bond statutes, and election laws. *Douglass v. Pike County*, 101 *U.S.* 677 (1880); *Chicot County Drainage District v. Baxter State Bank*, 308 *U.S.* 371 (1940); *Allen v. State Board of Elections*, 393 *U.S.* 544 (1968); *Cipriano v. City of Houma*, 395 *U.S.* 701 (1969); *City of Phoenix v. Kolodziejski*, 399 *U.S.* 204 (1970); *Buckley v. Valeo*, 424 *U.S.* 1 (1976).

Despite the constraints of Article III, the Court has exercised its jurisdiction where there is an active controversy between the parties which is likely to recur although the case before the Court has become moot. *Honig v. Doe*, 484 *U.S.* 305 (1988) (illegal exclusion of mentally disabled adolescent from school likely to recur); *Burlington Northern R. Co. v. Maintenance Way Employees*, 481 *U.S.* 429, 436, n.4 (1987) (future disputes likely over a collective bargaining agreement); *Southern Pacific Terminal Co. v. I.C.C.*, 219 *U.S.* 498, 515 (1911) (ruling of I.C.C. likely to be repeated).

> moves with a freedom which stamps its action as creative. The law which is the resulting product is not found, but made. [*Id.* at 113-15]

In the same essay, then Judge Cardozo recognized that, although judge-made law generally operates retrospectively with little or no hardship, "when the hardship is felt to be too great or to be unnecessary, retrospective operation is withheld." *Id.* at 147.[15] The use of a dispute between two parties as a "spring board" to a broad rule of constitutional law would seem as legislative in character as the prospective overruling of a constitutional decision. Fallon and Meltzer, "New Law, Non-Retroactivity and Constitutional Remedies," 104 *Harv.L.Rev.* 1733, 1801 (1991).

Any concern that prospective overruling makes overruling too easy and threatens respect for the judicial system, *Beam*, 111 *S.Ct.* at 2444 (plurality opinion), is belied by this Court's infrequent adoption of prospective overruling in the civil arena, both before and after *Chevron Oil.*[16] In New Jersey prospective overruling is not the

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[15] In *Great Northern Railway Co. v. Sunburst Oil & Ref. Co.*, 287 *U.S.* 358, 365-66 (1932), in an opinion authored by Justice Cardozo, the Court declined to incorporate into the constitutional canon of fundamental due process of law, the Blackstonian legal doctrine that, when prior law is overruled, it must be viewed as if it had never existed.

[16] In addition to the cases cited in note 14 *supra*, *see England v. Louisiana State Bd. of Medical Examiners*, 375 *U.S.* 411 (1964) (under abstention doctrine if litigant freely submits federal claim to state courts, he is precluded from litigating

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rule. Only in *Salorio v. Glaser*, 93 *N.J.* 447, 461 *A.*2d 1100 *cert. denied*, 464 *U.S.* 993 (1983), did a New Jersey court agree to prospective overruling in a tax case. In *Exxon Corp. v. Hunt*, 109 *N.J.* 110, 123-24, 534 *A.*2d 1 (1987), the New Jersey Supreme Court refused to give prospective effect to this Court's decision in that case, 475 *U.S.* 355 (1986), on the ground that the decision did not establish a new principle of law under *Chevron Oil*. In *Private Truck Council of America v. State*, 111 *N.J.* 214, 544 *A.*2d 33 (1988), aff'g 221 *N.J. Super.* 89, 534 *A.*2d 13 (App. Div. 1987), the New Jersey Supreme Court struck down the State's retaliatory truck tax under the Commerce Clause and rejected, without comment, the State's prospectivity argument. In *American Trucking Ass'n v. Kline*, No. 07-14-1667-85 MVT (Sept. 8, 1988) the New Jersey Tax Court concluded in a letter opinion[17] that this Court's decision in *American Trucking Ass'ns, Inc. v. Scheiner*, 483 *U.S.* 266 (1987),

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federal claim in federal court, but rule would not be applied to pending case). *Lemon v. Kurtzman*, 411 *U.S.* 192 (1973) (statute authorizing public subsidy to private sectarian schools violated First Amendment but ruling applied prospectively because schools relied on presumptively valid statute); *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 *U.S.* 50 (1982) (ruling that Bankruptcy Act of 1978 unconstitutionally conferred Article III judicial powers on bankruptcy judges would apply prospectively); *Smith* (decision that flat highway taxes are unconstitutional would apply prospectively because decision established a new principle of law).

[17] The case was settled after this Court's decision in *Smith*. A copy of the opinion is included in the appendix at Rsa 1a-20a.

should be retroactive because it was foreshadowed by *Complete Auto Transit, supra.*

The Court's recent decisions have done much to level the playing field between state taxing authorities and taxpayers. In *McKesson Corp.*, the Court curtailed the common law volunteer rule, under which taxes "voluntarily" paid could not be recovered, by holding that the Due Process Clause requires meaningful retroactive relief if a state forces a taxpayer to pay before obtaining a judicial ruling that the tax is valid. In *Dennis v. Higgins* 111 *S.Ct.* 865 (1991), the Court facilitated constitutional challenges to state taxes by holding that attorneys' fees under 42 *U.S.C.* § 1988 are available to taxpayers who successfully challenge a state tax under the Commerce Clause.

Unlike the common law volunteer rule, the doctrine of purely prospective overruling in the civil arena has stood the test of time, most likely because it comports with an elemental sense that one should be able to rely on the current state of the law. Prospective overruling thus serves the goal of predictability in the law. Here, however, retroactive overruling is appropriate because *ASARCO* and *Woolworth* were never settled precedent, and Bendix did not rely on the two decisions when it decided to sell the ASARCO stock.

POINT III

IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE COURT SHOULD CONSTRUE THE DUE PROCESS CLAUSE TO PERMIT A NONDOMICILIARY STATE TO APPORTION ALL THE INCOME OF A SEPARATE MULTISTATE CORPORATE TAXPAYER, THEREBY ACHIEVING PREDICTABLE, FAIR, AND ECONOMICALLY REAL RESULTS.

The constitutional principle we propose is simply that when a nondomiciliary state seeks to impose its corporate net income tax on a single multistate taxpayer, the only nexus required by the Due Process Clause is that the taxpayer be engaged in business within the taxing state. In that event the nondomiciliary state has a sufficient connection with the taxpayer to include all its income in the apportionable tax base. The unitary business is congruent with the single corporation. On the other hand, when a state seeks to compute its tax based on a combination of income from two or more separate legal entities, the Clause requires that the separate entities be linked through a unitary business. Without that link, the taxing state may have insufficient connections with the separate legal entities based outside its borders to satisfy the Due Process Clause.

A. Nexus to Tax a Multistate Corporate Taxpayer Should Be Based on the Corporation's Presence within a Nondomiciliary State.

In place of *ASARCO* and *Woolworth*'s requirement of an operating relationship between the payor and payee of intangibles income, we suggest that the Court adopt a rule of full apportionment grounded in the fundamental

purpose of the Due Process Clause. As made clear in Point I above, insofar as state taxes are concerned, the Clause requires that the person, property, or transaction sought to be taxed must be within the territorial confines of the taxing state. *Miller Bros.*, 347 *U.S.* at 344-45. When this is the case, the taxing state has given something "for which it can ask return." *J.C. Penney Co.*, 311 *U.S.* at 444. As a corollary to that principle, when a tax is based on doing business within the taxing state, the fact that events occurring outside the state may trigger the tax "does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction." *Id.* at 445.

In each case the controlling question is who or what is being taxed and whether that person or transaction is within the state's territorial jurisdiction. If the tax is a transactional tax, the transaction must be localized within the taxing state. *See, e.g., American Oil Co. v. Neill*, 380 *U.S.* 451 (1965) (where taxable event was the receipt of gasoline by a licensed dealer and delivery to the dealer occurred outside the taxing state, fact that dealer was licensed and did business within taxing state did not create nexus over the taxed transaction); *Int'l Harvester Co.* discussed *supra* note 2. On the other hand, if an out-of-state seller is being forced to collect the state's use tax, the question is whether the seller, not the sale, is sufficiently within the state's territorial jurisdiction. *See Miller Bros.*, (where tax was on use of property within taxing state, out-of-state vendor having a lack of purposeful contacts with taxing state could not be required to collect

the tax); *National Geographic Society v. California Bd. of Equalization, supra,* discussed *supra* note 2.[18]

A state corporate net income or franchise tax is a tax on corporations based on income derived from business activities within the taxing state. *See e.g. N.J.S.A.* 54:10A-2; *Northwestern States Portland Cement Co. v. Minnesota,* 358 *U.S.* 450, 464 (1959) (concluding that the net income taxes at issue did not offend the Due Process Clause because "[t]he taxes imposed are levied only on that portion of the taxpayer's net income which arises from its activities within the taxing State"). Since the state is exercising its taxing power with respect to a corporation doing business within it, the presence of that corporation within the taxing state satisfies the requirements of the Due Process Clause. "The requisite 'nexus' is supplied [because] the corporation avails itself of the 'substantial privilege of carrying on business' within the State. . . . " *Mobil,* 445 *U.S.* at 437, quoting *J.C. Penney,* 311 *U.S.* at 444-45. Since the taxing state has jurisdiction over the corporation, there should be no requirement of a further nexus as to particular out-of-state activities and/or particular streams of income. In a single corporation context,

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[18] *See also Int'l Harvester Co. v. Wisconsin Dep't of Taxation,* 322 *U.S.* 435, 441-42 (1944) (where tax was for doing business within taxing state and was withheld from dividends paid to shareholders, fact that shareholders were nonresidents did not destroy the state's power to tax the corporation's earnings); *Cleveland, Painesville and Ashtabula R.R. Co. v. Commonwealth of Pennsylvania,* 82 *U.S.* 179 (15 *Wall.* 300) (1873) (state tax withheld from interest paid by domiciliary corporations on corporate bonds to nonresidents was a tax on property of the bondholders and thus exceeded the state's taxing jurisdiction).

there is thus no theoretical justification for a unitary business principle when employed to fragment the corporate entity over which the taxing state has jurisdiction. The governing constitutional principle is clear. Jurisdiction to tax a single corporation extends the state's taxing power to the corporation's entire income.[19]

B. The Proposed Rule Would Be Consistent with the Court's Prior Cases.

Recognition of the fact that all income of a single corporation is earned in a unitary business does not mean rejecting the principles set forth in the Court's long line of unitary business cases preceding *ASARCO* and *Woolworth*. With the exception of those two cases, none of the Court's unitary business cases involving the apportioned taxation of *net income* have held that the taxpayer's operations were not unitary.[20] Throughout these earlier cases,

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[19] The idea is not revolutionary. Shortly after *ASARCO* and *Woolworth* were decided, a former tax commissioner from a state that apportions the entire tax base argued that, "The requisite nexus is supplied when the corporation and some of its income producing activities are connected with the taxing jurisdiction. If this is the case, all of that corporation's income may be included in a fairly apportioned tax base for state income tax purposes. There is no requirement that each increment of income have a relationship to the taxing jurisdiction. *Moorman . . . ; Northwestern States Portland Cement. . . .* " Lathrop, "Due Process Considerations and the Apportionment of Dividend Income: A Dissent From the *ASARCO* and *Woolworth* Decisions," 16 *Tax Notes* 1 (July 5, 1982).

[20] *See e.g. United States Glue Co. v. Oak Creek*, 247 *U.S.* 321 (1918) (apportioned net income tax was not a direct tax on

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the Court applied the unitary business principle to the activities of a single corporation and invariably concluded that the single corporation's business was indivisible (see Rb20-23). Not only are the holdings consistent with the proposed rule that the unitary business of a

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interstate commerce); *Underwood Typewriter Co. v. Chamberlain*, 254 *U.S.* 113 (1920) (where profits were earned in series of transactions beginning with manufacturing in taxing state and ending with sales in other states, state could apportion the total profits); *Bass, Ratcliff & Gretton v. State Tax Comm'n*, 266 *U.S.* 271 (1924) (corporation that manufactured and sold ale was unitary; federal tax loss thus not determinative); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 *U.S.* 123, 133 (1931) (generally, all factors in a manufacturing "enterprise are essential to the realization of profits," but apportionment formula operated unfairly under the particular facts); *Butler Bros. v. McColgan*, 315 *U.S.* 501 (1942) (common ownership, centralized management, and economies of scale established that taxpayer's territorially organized business was unitary); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 *U.S.* 425 (1980) (foreign subsidiaries were part of taxpayer's integrated petroleum business); *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 *U.S.* 207 (1980) (petroleum company characterized by vertical integration and centralized management was unitary business).

The railroad property tax cases of *Wallace v. Hines*, 253 *U.S.* 66 (1920) and *Norfolk and Western R. Co. v. Missouri Tax Commission*, 390 *U.S.* 317 (1968), in which the Court concluded that certain out-of-state property could not be included in determining the apportioned value of the railroad's in-state property reflect the inherent difference between a tax on tangible property that can be seen and sited to a particular location, thereby providing a benchmark against which to test the fairness of an apportionment formula, and a tax on income that has no readily identifiable source. *See Wheeling Steel Corp. v. Fox*, 298 *U.S.* 193, 212 (1936).

single corporation include all its activities, but the thinking of these cases leads logically to the same conclusion. In *Butler Bros.*, the Court suggested that manufacturing enterprises are virtually always unitary. Quoting from *Hans Rees' Sons*, 283 *U.S.* at 133, the Court stated that, "[T]he enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." *Butler Bros.*, 315 *U.S.* at 508. In *Mobil*, the Court cast doubt on any attempt to geographically source particular streams of income, stating that, since the "factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' " *Mobil*, 445 *U.S.* at 438. These rationales are consistent with a conclusion that the unitary business may properly be defined as all the activities of a single corporation because all the activities, disparate as they may seem, are linked by common ownership, common management and presumptive economies of scale and transfers of value. *Id.*

The Court's unitary business cases subsequent to *Container* point in the direction of the principle we propose because the Court consistently has refused to splinter the unitary business of a single corporate entity. *See Shell Oil Co. v. Iowa Dep't of Rev.*, 488 *U.S.* 19 (1988) (oil and gas production income from Outer Continental Shelf held includable in preapportionment tax base); *Amerada Hess Corp.* (nondomiciliary state's denial of a deduction for site-specific, out-of-state costs did not prevent the apportioned taxation of unitary business' net income); *Trinova Corp.*, 111 *S.Ct.* 831 (unitary business' value added

can no more be sourced to a geographic location than can income, even though "discrete components" of the tax base may appear "in isolation susceptible of geographic designation"). If the Due Process Clause does not require the fragmentation of the unitary tax base to account for wellhead costs, compensation, and depreciation, the Clause cannot logically require that the same tax base be fragmented to account for "discrete components" of income.

These post-*Container* cases suggest as well that the Court has moved away from the early rationale of the unitary business principle which justified apportioned taxation only when income could not in fact be sourced to a particular location. *See Underwood Typewriter Co.*, 254 *U.S.* at 121; *Mobil*, 445 *U.S.* at 452 (Stevens, J. dissenting), and J. Hellerstein, *State Income Taxation I Corporate Income and Franchise Taxes*, 389-92 (1983).

C. Unitary Links Would Be Required to Combine Separate Corporate Entities.

Testing our proposed principle in the setting of a combined report confirms that it is conceptually right. In the case of a combined report as used in California and other states, the taxpayer's preapportionment tax base includes not only the income of the taxpayer but the income of other corporate affiliates linked by the requisite degree of control and conducting a unitary business with the taxpayer. *See Container*, 463 *U.S.* at 168.[21] While

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[21] A helpful discussion on the mechanics of combined reporting is found in Warren, "Principles of Formulary Apportionment," 1 *State & Local Tax Portfolio Series*, 241-48 (1989).

the taxpayer filing the combined report must be within the territorial jurisdiction of the taxing state, there is no requirement that other members of the unitary group whose income is being combined have any presence there. As there may be no jurisdiction over the person of these separate legal entities, the Due Process Clause requires that the taxing state obtain nexus in some other way over the income of these separate corporations. *Miller Bros.*, 347 *U.S.* at 344-45. The necessary link is created by the existence of a unitary business *between* the separate corporate entities, specifically a degree of control and operating relationships, which create transfers of value on an operational level. *Container*, 463 *U.S.* at 166. Thus, the Court's holding and reasoning in *Container* are fully consistent with the proposed principle. In a combined reporting situation, operating relationships between separate corporations are required by the Due Process Clause because the taxing state otherwise may have no connection with the out-of-state income that is included in the tax base.[22]

D. Fair Apportionment Would Continue To Be Tested under the Internal and External Consistency Tests.

To satisfy the second prong of the Due Process Clause and the fair apportionment requirement of the

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[22] Again, under the scheme of the New Jersey CBT Act, the preapportionment tax base does not include the income of any corporation other than the one being taxed. The income of unitary affiliates is not included; what is included are 50% of dividends paid by such affiliates to the taxpayer or other intangibles income such as capital gains and interest. *See* Rb12-13.

Commerce Clause, a state may tax only that portion of a nondomiciliary corporation's net income that is "rationally related to 'values connected with the taxing State.' " *Moorman*, 437 *U.S.* at 273, quoting *Norfolk & Western R. Co.*, 390 *U.S.* at 325; *Mobil*, 445 *U.S.* at 436-37. In *Container* the Court elaborated on the requirement of fair apportionment, stating that a tax must have both internal consistency and external consistency. 463 *U.S.* at 169. The internal consistency test is met in the case of an apportioned net income tax if "the formula . . . [is] such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." *Id.* Full apportionment of all corporate income meets the internal consistency test because, if every state had a comparable taxing scheme, no more than 100% of a corporation's income would be subjected to tax. To meet the external consistency test, "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.* The three-factor formula in general meets the external consistency test because "payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." *Id.* at 183.[23]

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[23] There is substantial disagreement among commentators as to the theoretical basis for the three-factor apportionment formula, some believing that its function is to source the corporation's income, others that the benefits and protection afforded by each state should control. *See* J. Hellerstein, *State Taxation I Corporate Income and Franchise Taxes, supra* at 368-70, citing authorities; R. Lathrop, *supra*, at 37 on LEXIS.

This case does not raise an issue of external consistency because petitioner has failed to pursue the issue in this Court.[24] Nevertheless, since the Court is interested in governing constitutional principles and since our proposed rule would increase the territorial reach of the states' taxing power, some discussion of fair apportionment seems appropriate.

On a theoretical basis, it might appear that, if intangibles income is to be included routinely in the tax base, the three-factor formula should give some recognition to the property producing the income. *Mobil*, 445 *U.S.* at 460-61 (Stevens, J. dissenting).[25] With minor exceptions for particular industries, no state includes intangible property in the property factor. *See N.J.S.A.* 54:10A-6(A); 1 *Multistate Corporate Income Tax Guide* ¶ 152 (CCH). On further study, it is not so clear that including intangible property in the factor is the correct solution. If income from intangibles is an " 'integral part' " of a unitary business, *ASARCO*, 458 *U.S.* at 347 (O'Connor, J., dissenting), it may be just as accurate conceptually to conclude that such income is properly apportioned using the three-

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[24] Bendix argued the issue in the lower courts with no success. *See* Pet. App. A at 22a-24a; Pet. App. C at 66a-67a.

[25] Another solution would be to include the factors of the issuers of the intangibles in the three-factor formula of the payee. *Mobil*, 445 *U.S.* at 460-61 (Stevens, J. dissenting). This adjustment appears to be inconsistent with the theory of a statute, such as New Jersey's CBT Act, that taxes the income of the payee and does not use combined reporting. Moreover, while the solution may have some conceptual appeal when applied to dividends from controlled subsidiaries, which might be regarded as a proxy for the subsidiaries' income, the idea appears of questionable validity when applied to capital gains that are not the issuer's income in any sense.

factor formula without adjustment. The three-factor formula reflects the manner in which income is generated throughout the unitary business, and intangibles income arises as a result of the activities of the entire unitary business. *See* the initial Brief *Amicus Curiae* of Multistate Tax Commission in Support of Respondent at 25-27. Moreover, as a practical matter, inclusion of intangible property in the formula raises the difficult issue of determining its situs. *Mobil*, 445 *U.S.* at 445; *ASARCO*, 458 *U.S.* at 345-47 (O'Connor, J., dissenting); *Curry v. McCanless*, 307 *U.S.* 357 (1939); *Ford Motor Credit Co. v. Dep't of Revenue*, 111 *S.Ct.* 2049 (1991), aff'g by an equally divided court, 537 *So.*2d 1011 (Fla. App. 1st Dist. 1988).

Due to the theoretical uncertainty, practical problems, and absence of an adequate record, the Court should not attempt to resolve the fair apportionment issue in this case.[26] *J.C. Penney Co.*, 311 *U.S.* at 445. An adequate record would include a complete picture of a multistate corporation's tax liabilities throughout the states in which it did business. Apparent overtaxation by one state may be mitigated by undertaxation elsewhere. The guiding principle should be the practical effect of the tax, *Complete Auto Transit*, 430 *U.S.* at 279, and the economic reality of the taxpayer's actual tax burden.

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[26] It should be noted that the proposed rule would not create the problem; the problem exists already whenever income from intangibles is included in the apportionable tax base.

E. The Potential for Double Taxation is Not a Constitutional Impediment.

The possible disadvantage of the principle we propose – full apportionment of all income realized by a single corporation – is an increase in the potential for double taxation. A constitutional rule that permits the states to apportion all income of a single corporation increases the risk of double taxation because a portion of the same income would be treated by the UDITPA states as nonbusiness income and allocated 100% to the corporation's commercial domicile. The question is thus whether an increased risk of double taxation is constitutionally permissible. We believe it is.[27]

The principles discussed to this point – nexus and fair apportionment – derive from both the Due Process and Commerce Clauses. *Amerada Hess*, 490 *U.S.* at 79-80; *Trinova*, 111 *S.Ct.* at 829-832 (analyzing issue of fair apportionment under Commerce Clause); *Moorman*, 437 *U.S.* at 271-75 (analyzing issue of fair apportionment under Due Process Clause); *Container*, 463 *U.S.* at 169-71 (analyzing issue of fair apportionment under Due Process and Commerce Clauses). The issue of double taxation, however, is plainly an issue under the Commerce Clause, specifically whether the tax discriminates against interstate commerce. *See Moorman*, 437 *U.S.* at 276; *Mobil*, 445

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[27] Like the fair apportionment issue discussed above, the double taxation problem is one of degree since the current system may produce double taxation by a UDITPA and full apportionment state. *Moorman*, 437 *U.S.* at 278-79. As indicated in the appendix to this brief (Rsa 21a-23a), allegations of double taxation of intangibles income are relatively infrequent.

U.S. at 443. The holdings in *Moorman, Mobil* and *Container* make clear that the potential for double taxation in the context of an apportioned net income tax does not render the apportioned tax unconstitutional.

Moorman, having its manufacturing facilities in Illinois and salesmen and warehouses in Iowa, argued that the Iowa single-factor sales formula resulted in double taxation of a portion of its net income because Illinois used the standard three-factor formula. Finding no actual double taxation, the Court rejected Moorman's argument on the ground that the Commerce Clause does not require the states to adopt a single, uniform system of taxation that would avoid all possible duplication. *Moorman*, 437 *U.S.* at 277-279. Specifically, due to the states' differing treatment of nonbusiness income, with some states attributing such income to a single situs and others apportioning it, the potential for double taxation is inherent in the federal system. *Id.* at 278-79. In *Mobil*, the Court rejected the idea that the taxing power of the state of commercial domicile " should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other states." *Id.* at 446. Since several states had an adequate connection with Mobil's dividend income and since Vermont's tax was on income, not property, Vermont's apportioned tax was not forbidden by the Commerce Clause. *Id.* Continuing the theme that income and property taxes differ, the Court in *Container* upheld California's apportioned taxation of the income of Container's subsidiaries, income that was in fact taxed by

other nations. *Container*, 463 *U.S.* at 187-88.[28] Unless the Court were to reject the principles of these cases, any greater risk of double taxation created by our proposed rule is constitutionally acceptable.

F. The Proposed Rule Would Permit State Law Variations.

As a corollary, we strongly urge that the Court adopt a rule of full apportionment that would permit the states to limit their taxing power if they so choose. "[T]he Constitution imposes no single formula on the States," *Container*, 463 *U.S.* at 164, and, more pointedly, "the unitary business concept . . . is not, so to speak, unitary. . . . ," *id.* at 167, and *see Moorman*, 437 *U.S.* at 279. If a state chooses, by statute or otherwise, not to exercise its full taxing power under the Due Process Clause, it should be permitted to make that choice. The UDITPA states that distinguish between business and nonbusiness income should be able to continue to do so. States wishing to entertain the possibility of two or more discrete,

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[28] State personal income taxes and intangible property taxes create a greater risk of double taxation. In the case of personal income taxes, the state of residence or domicile can tax all the income of a resident individual, while another state may tax the same income to the extent it is earned within the taxing state. *New York ex rel. Cohn v. Graves*, 300 *U.S.* 308, 313 (1937); *Shaffer v. Carter*, 252 *U.S.* 37 (1940). In *Curry v. McCanless*, 307 *U.S.* 357 (1939), the Court held that two states could each impose its inheritance tax on the transfer of intangible property to a testamentary trust. The state of the decedent's domicile had the power to tax the transfer, and the state where the transfer in trust occurred had a similar power.

nonunitary lines of business within a single corporation should not be constrained. The distinctions, however, would be based in state law. *Cf. Container*, 463 *U.S.* at 167-68.[29]

G. The Proposed Rule Would Be Predictable, Consistent with Economic Reality, and Fair.

The advantages of the rule we propose include its clarity and predictability and its congruence with economic reality. Within single corporate entities, it would no longer be necessary to attempt "slicing a shadow." *Container*, 463 *U.S.* at 192. Nor would the inquiry be directed at determining "largely unquantifiable transfers of value that take place among the components of a single enterprise." *Id.* at 164-65. Taxpayers and state taxing authorities alike would be relieved of the expense and

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[29] A permissive rule of full apportionment would similarly leave in place New York State and New York City's unique approach to the apportionment of investment income under which a taxpayer derives an investment allocation percentage reflecting the degree of presence within the taxing jurisdiction of the issuers of the securities in which the taxpayer has invested. *See Allied-Signal, Inc. v. Commissioner of Finance*, 79 *N.Y.S.*2d 73 (N.Y.Ct.App. 1991), involving the same capital gain that is at issue here and concluding that under New York City's statutory scheme the gain was apportionable based on ASARCO's presence in the taxing jurisdiction. As indicated by petitioner's counsel during argument, New Jersey bases its claim to tax a share of the ASARCO gain on a different theory, so that the presence of ASARCO in New Jersey is irrelevant (T4-15 to T5-20). New Jersey agrees with petitioner on this point.

uncertainty of litigating and relitigating the unitary business issue, with each case turning on its peculiar facts. State courts would be relieved of the burden of dealing with elusive legal concepts and lengthy factual records where "the line between 'historical fact' and 'constitutional fact' is often fuzzy at best." *Id.* at 176.

In addition, the rule would align the nexus requirement of the Due Process and Commerce Clauses with the economic reality of corporate investing. In its more recent cases involving the taxation of multistate businesses, the Court has tried "to accommodate the necessary abstractions of tax theory to the realities of the marketplace." *Trinova*, 111 *S.Ct* at 828. The marketplace draws no firm line between passive and operational investments. Companies make all kinds of investments that are as much a part of their business as their traditional operations. An article in *Forbes Magazine* lists 15 companies having net cash equal to at least 45% of their market value and characterizes one of the companies, a brewing company, as a 'money market fund.' Hardy and Balancia, "Liquid Assets," *Forbes Magazine* 130 (Feb. 18, 1991). There is a growing trend among American businesses to take equity positions in suppliers and firms with promising technology. "Learning from Japan," *Business Week* (Jan. 27, 1992). In the first half of the 1980's, many large companies turned to acquisitions as a less expensive alternative to building from within and in some cases to achieve countercyclicality. In 1984 alone, "2543 deals were struck" for a total of $122 billion. Prokesch and Powell, "Do Mergers Really Work?" *Business Week* (June 3, 1985). To take a single example, Dupont acquired Conoco, Inc. purportedly as a source of feedstocks. "DuPont/Conoco – Making

the Marriage Work," *Chemical Week* (Sept. 2, 1981); Samuelson, "Merger Mania," 13 *National Journal* 2126 (Nov. 28, 1981). But with the acquisition of Conoco came Consolidation Coal, the second-largest U.S. coal producer, the acquisition of a 20% interest in DuPont by Seagram, and uncertainty as to DuPont's commitment to its stated strategy of building up its health care, pharmaceuticals, and related businesses. Characterizing the post-merger company, DuPont's chairman was reported to have stated: "What we are is a broadly diversified company. . . . We're not an oil company, obviously, nor are we a purely chemical company." "DuPont/Conoco . . . ", *supra*.

The accounting literature reflects a similar ambiguity in classifying investing activities and operating activities. The Financial Accounting Standards Board ("FASB") has defined investing activities for purposes of the cash flow statement as:

> making and collecting loans and acquiring and disposing of debt or equity instruments and property, plant, and equipment and other productive assets, that is, assets held for or used in the production of goods or services by the enterprise (other than materials that are part of the enterprise's inventory). ["Statement of Cash Flows," *Statement of Financial Accounting Standards No.* 95, § 15 (FASB, Nov. 1987)].

Operating activities were defined as any activity other than investing or financing activities. *Id.* at § 21. The FASB has recognized that certain cash receipts and cash payments may have aspects of more than one class of cash flow, in which case the appropriate classification

depends upon the activity that is likely to be the predominant source of the cash flow. *Id.* at § 24, and *see Statement of Financial Accounting Standards No.* 102, § 25 (FASB, Feb. 1989).[30]

To require state taxing authorities and courts to draw a constitutional line between operational and passive investments when the marketplace does not is unreasonable. The facts and records regarding corporate investing are within the taxpayer's control. The distinction between operational and passive investments has proved elusive and subject to manipulation in the federal income tax context, specifically the *Corn Products*[31] exception to the statutory definition of capital asset. *See W.W. Windle Co. v. Commn'r of Internal Revenue*, 65 *T.C.* 694, 712-13 (1976), *appeal dismissed* 550 *F.*2d 43 (1st Cir. 1977), *cert. denied* 431 *U.S.* 966 (1977) (requiring capital asset classification where taxpayer had mixed investment and business motives and alluding to opportunity for claiming ordinary losses on unprofitable investments and capital gains

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[30] There is a similar gray area in determining when an investment may be reported on the equity method of accounting. Accounting Principles Board Opinion No. 18 provides that the equity method must be used if an investor in common stocks has the ability to exercise significant influence over the issuer, that significant influence will be presumed with an equity interest of 20% or more, but that the presumption may be overcome by predominant evidence to the contrary. *Accounting Standards: General Standards Current Report*, § 182.104, FASB June 1990. The FASB has been reviewing the 20% dividing line to determine whether it should be changed. *FASB Status Report*, 3-4 (Oct. 11, 1988).

[31] *Corn Products Refining Co. v. Comm'r*, 350 *U.S.* 46 (1955).

on profitable ones); *Union Pacific R.R. Co., Inc. v. United States*, 524 F.2d 1343, 1359 (Ct. Cl. 1975) (stocks in subsidiaries were not capital assets because their acquisition "was accomplished for an operating, business purpose and the stock was held as part of the operation of plaintiff's business . . . "). In *Arkansas Best Corp.*, the Court eliminated the business-motive test as an exception to *IRC* § 1221, pointing out the potential for abuse and the whipsaw effect of the doctrine. *Id.* at 222-23. Our proposed rule of full apportionment would have a similar beneficial impact in the state tax context.[32]

A final advantage of the proposed rule is that the in-state tax base would be determined exclusively by the apportionment factor, which is what the factor is designed to do. In appropriate cases, the factor can be adjusted to reflect the proper amount of income attributable to a state. *See, e.g., N.J.S.A.* 54:10A-8. The adjustments can be tuned to particular factual circumstances. The unitary business principle, on the other hand, when applied to single corporations produces extreme, unrealistic results – large amounts of income are either in or out of the tax base according to tenuous, artificial distinctions.

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[32] Bendix reported the ASARCO investment on the equity method (J.A. 168, ¶ 55) thereby indicating to the public that it had the ability to exercise significant influence over ASARCO. When it came to the company's New Jersey tax liability, the Bendix CEO testified that he and the other Bendix director who sat on ASARCO's board had virtually no influence on the board (J.A. 85; and *see* J.A. 168, ¶ 54; J.A. 169, ¶ 62).

CONCLUSION

For the foregoing reasons and those set forth in New Jersey's initial brief, the judgment of the Supreme Court of New Jersey should be affirmed.

Respectfully submitted,

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April 1992

NOT FOR PUBLICATION WITHOUT
THE APPROVAL OF THE TAX COURT
COMMITTEE ON OPINIONS
TAX COURT OF NEW JERSEY

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Re: American Trucking Association, v. Robert Kline, *et al*
Docket No. 07-14-1667-85MVT

Counsel:

This letter constitutes the opinion of the court in the above matter. Plaintiffs, American Trucking Association, Inc., Bee Line Motor Freight, Inc., Moss Trucking Company, Inc. and C.P. Belue, Sr., on behalf of themselves and others similarly situated, have challenged the New Jersey $25 truck identification marker fee (decal fee).[1] *N.J.S.A.* 54:39-10. This court has previously certified a class of motor carriers having their principal places of business in states other than New Jersey, and denied plaintiffs' application for the creation of an escrow fund into which the decal fees in contest would be deposited.

Plaintiffs seek refund of decal fees paid by plaintiff class from July 10, 1984 through August 18, 1987. On April 25, 1986, consistent with this court's opinion of February 19, 1986 (reported at 8 *N.J. Tax* 181 (Tax Ct. 1986)) and Order of March 25, 1986, plaintiffs filed a single refund claim on behalf of the plaintiff class, claiming refunds dating back to July 10, 1984. On or about September 28, 1987, the plaintiff class filed a second refund claim covering the period subsequent to the period covered by the first refund claim.

On June 23, 1987, the United States Supreme Court ruled that Pennsylvania's $25 axle tax, a flat tax, discriminated against interstate commerce, bearing more heavily on a cost-per-mile basis on out-of-state trucks. *American*

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[1] Although referred to as a fee, this imposition is actually a tax. *American Trucking Ass'n v. Kline*, 8 *N.J. Tax* 181, 184 (Tax Ct. 1986). *See also Bellington v. East Windsor*, 17 *N.J.* 558, 564 (1955).

Trucking Ass'ns, Inc. v. Scheiner, 483 *U.S.* ___, 104 *S.Ct.* 28-29, 97 *L.Ed.* 2d 226 (1987).

On August 18, 1987, following *Scheiner*, the State conceded that New Jersey's decal fee violates the Commerce Clause under *Scheiner*, but reserved the right to argue that (1) the $25 fee is constitutional to the extent that it covers the State's actual cost of issuing decals and (2) the $10 temporary permit fee is constitutional under *Scheiner*. The State also contends that the decal fee should be deemed unconstitutional only prospectively from June 24, 1987. On August 19, 1987, the State ceased collecting the decal fee.

Plaintiff American Trucking Association, Inc. ("ATA") is a non-profit corporation incorporated under the laws of the District of Columbia. ATA is a trade association of motor carriers, state trucking associations and national trucking conferences. A substantial number of ATA's members are subject to and affected by the increased $25 per truck identification marker fee.

Plaintiff Bee Line Motor Freight, Inc. ("Bee Line"), a Nebraska corporation, is an interstate motor common carrier, as defined in the Interstate Commerce Act. During the 1984 fiscal year of the New Jersey motor fuels use tax, Bee Line purchased 45 decals and thus qualified 45 of its motor carrier vehicles for operation into and through the State of New Jersey. During 1984, all of Bee Line's motor carrier vehicles were registered in Nebraska.

Plaintiff Moss Trucking Company, Inc. ("Moss"), a North Carolina corporation, is an interstate motor common carrier as defined in the Interstate Commerce Act. During the 1984 fiscal year of the New Jersey motor fuels

use tax, Moss purchased 193 decals, qualifying 193 of its motor carrier vehicles for operation into and through the State of New Jersey. During 1984, most of Moss's motor carrier vehicles were registered in North Carolina, but some were registered in Virginia and Delaware.

Plaintiff C.P. Belue, Sr., doing business as Belue Trucking ("Belue"), is a sole proprietorship, with his principal place of business in Campobello, South Carolina. During the 1984 fiscal year of the New Jersey motor fuels use tax, Belue purchased 23 decals, qualifying 23 of his motor carrier vehicles for operation into and through the State of New Jersey. During 1984, most of Belue's motor carrier vehicles were registered in South Carolina.

The class, as certified by the court and represented by the above-named plaintiffs, is all interstate motor carriers whose principal places of business are located outside the State of New Jersey and who were subject to the requirements and liable for payment of the decal fee during the period July 10, 1984 through August 18, 1987.

Plaintiffs allege that Bee Line, Moss and Belue have been assessed and have paid all applicable fees and taxes called for under the laws of the State of New Jersey including the decal fee.

Pursuant to *R.* 4:33-1, a motion to intervene, on behalf of Owner-Operators Independent Drivers Association of America, Inc. ("OOIDA"), Robert J. Heinsohn, Betty J. Colvin, George A.Tibbetts and John T. Overstreet, was granted.

OOIDA is a non-profit organization incorporated under the laws of the State of Missouri, with its principal

office in Oak Grove, Missouri. OOIDA is a national trade association representing owner-operators, with an active membership of nearly 8,000 owner-operators from all states, except Hawaii. Robert J. Heinsohn, Betty J. Colvin, George A. Tibbets and John T. Overstreet are owner-operators who have paid the New Jersey decal fee.

The defendants in this action are the New Jersey state officials empowered by law to administer and enforce the challenged legislation. While the identity of certain of the officials may have changed over time, the responsibilities of the offices remain the same.

The motor fuels use tax statutory scheme requires that motor carriers operating vehicles within New Jersey annually register each vehicle and receive from the Director of the Division of Motor Vehicles identification markers to be displayed on each vehicle. *N.J.S.A.* 54:39A-10 imposes a flat fee for each marker issued.

The identification marker (decal) issued is affixed to the cab of each truck that is subject to the Motor Fuels Use Tax Act, *N.J.S.A.* 54:39A-1 *et seq.*, and evidences compliance with that act. The decal fee provides a source of revenue for the Transportation Trust Fund and covers the cost to the Bureau of Motor Carriers of issuing decals. The total cost of issuing decals is approximately $500,000 per year, or approximately $1 per vehicle. A decal is valid for the period April 1 through March 31 of the succeeding calendar year. If a carrier makes no more than six trips through the State within a calendar year, it may be issued single-trip permits valid for 96 hours, at a cost of $10 each, instead of the $25 decal. Payment of this fee is in

lieu of motor fuels use tax payments and reporting requirements.

When originally enacted in 1963, the decal fee was $2. From 1964 to 1979, the fee was $3 per motor vehicle. In 1979, the fee was increased to $6 per motor vehicle. A 1984 amendment to *N.J.S.A.* 54:39A-10 increased the annual decal fee from $6 to $25. The amendment took effect on passage on July 10, 1984, but because decals are valid from April through the following March 31, the increased fee was not collected by the State until the existing decals were required to be renewed for the motor fuels use tax year April 1, 1985 through March 31, 1986.

Total decal fee collections for the period July 10, 1984 through August 18, 1987 amounted to $41,145,543. Collections from out-of-state carriers accounted for 83-84% of total decals issued. Therefore, the total refund sought by plaintiffs is between $34,150,801 and $34,562,256. The State concedes that plaintiffs are entitled to a refund of $462,185–(before deducting the $1 per decal administrative cost), 84% of the fees paid from June 24, 1987 (the day after *Scheiner* was decided) through August 18, 1987 (the last day the State collected the fee).

Plaintiffs contend that: (1) the stipulation entered into by the parties on February 27, 1985 requires the State to refund illegally-collected taxes should the decal tax be declared unconstitutional, (2) the general rule of presumptive retroactivity of judicial decisions applies in this case because the *Scheiner* case was a logical and predictable application of the anti-discrimination principles announced in *Complete Auto Transit, Inc. v. Brady*, 430 *U.S.* 274 (1977), and retroactive application will not give rise

to inequitable results that would justify refusing refunds, (3) the State is not entitled to retain $1 of each decal fee as the cost of issuing the decal because the $25 decal fee is a discriminatory flat tax, and because the court cannot rewrite the tax provisions of the motor fuels use tax to create an administrative fee in lieu of a tax, (4) plaintiffs are entitled to interest on their refund, (5) class counsel are entitled to attorneys' fees, and (6) the court should authorize an appropriate distribution plan.

I

We first address the issue of whether the determination of unconstitutionality of the decal fee should be applied prospectively or retroactively. Is an unconstitutional statute a nullity from the moment of its adoption, or is the declaration of unconstitutionality effective only from the date of that determination? Prior law held in favor of the former notion. *Norton v. Shelton County*, 118 *U.S.* 425, 442, 30 *L.Ed* 178 (1886). However, in view of the harsh results that may occur when all past transactions made in reliance on a presumedly valid statute are invalidated, more recent decisions have held that, in each case, there must be a balancing of the constitutional requirements. The parameters of the analysis for this balancing are found in *Chevron Oil Company v. Huson*, 404 *U.S.* 97, 106, 92 *S.Ct.* 349, 355 (1971). Three factors were identified in that case to justify non-retroactivity:

> First, the decision to be applied non-retroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied or by deciding an issue of first impression whose resolution

> was not clearly foreshadowed. Second, it has been stressed that 'we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect and whether retrospective operation will further or retard its operation.' Finally, we have weighed the inequity imposed by retroactive application, for '[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the "injustice or hardship" by a holding of non-retroactivity.' 404 *U.S.* at 106-107, [citations omitted].

The *Chevron* case was followed by *Lemon v. Kurtzman*, 411 *U.S.* 492, 93 *S.Ct.* 1463 (1973). In the first *Lemon* case, 403 *U.S.* 602, 91 *S.Ct.* 2105, 29 *L.Ed.*2d 745 (1971), the state statute which permitted state payments to private and parochial schools had been found to be unconstitutional as violative of the First Amendment. The issue before the court in the second *Lemon* case (411 *U.S.* 492) was whether the decision in the first *Lemon* case should be applied retroactively, which would require the private and parochial schools to refund the monies unconstitutionally disbursed by the State, or applied prospectively only. The Court's decision was shaped in large part by consideration of the three factors discussed in *Chevron*.

In 1983 the New Jersey Supreme Court dealt with the prospectivity issue in the context of a state tax in *Salorio v. Glaser*, 93 *N.J.* 447, cert. den. 464 *U.S.* 993, 78 *L.Ed.* 2d 683 (1983). The Supreme Court, in holding the Emergency Transportation Tax Act (ETT) unconstitutional, applied its decision prospectively, permitting a six-month grace

period in which the State could continue to collect the tax. This holding was grounded in the State's "justifiable reliance upon the availability of the ETT funds," (93 *N.J.* at 465), the period of time that the taxing statute had been in effect (1961 to 1983), and the lack of financial harm to the New York residents who paid the tax and received a credit against their New York personal income tax in the same amount.

I deal first with the question of whether the invalidity of the decal fee is the result of a new principle of law, either overruling clear past precedent on which litigants may have relied or deciding an issue of first impression whose resolution was not clearly foreshadowed.

The nullification of the subject decal fee occurred as a direct result of the decision of the United States Supreme Court in *Scheiner, supra*. In that case, the Court was called upon to review two Pennsylvania statutes which imposed lump sum annual taxes on trucks, a $25 "marker fee" and an "axletax." These taxes were "flat taxes." The Court begins its opinion by stating that it is again asked to decide whether state taxes, as applied to an interstate motor carrier, violate the Commerce Clause. The Court says, "[t]hat statement of the question presented might equally well have introduced the Court's opinion in either *Spector Motor Service, Inc. v. O'Connor*, 340 *U.S.* 602, 71 *S.Ct.* 508, 95 *L.Ed* 573 (1951), or *Complete Auto Transit, Inc. v. Brady*, 430 *U.S.* 274, 97 *S.Ct.* 1076, 51 *L.Ed.* 2d 326 (1977), which overruled *Spector.*" *Scheiner, supra*, 107 *S.Ct.* at 2832. The specific issue before the Court was:

> Do the methods by which the flat taxes are assessed discriminate against some participants in interstate commerce in a way that contradicts the central purpose of the Commerce Clause? We find dispositive those of our precedents which make it clear that the Commerce Clause prohibits a state from imposing a heavier tax burden on out-of-state businesses that compete in an interstate market than it imposes on its own residents who also engage in commerce among states. 107 *S.Ct.* at 2839.

The *Scheiner Court* analyzed the subject taxes in terms of the *Complete Auto* test, reasoning that unapportioned flat taxes penalize interstate travel. In arriving at this conclusion, it considered an "internal consistency" test – the effect on commerce if many states imposed flat taxes, and the threat to national free trade that this action would have. They also examined the subject taxes and held "in practical effect, since they impose a cost per mile on appellants' trucks that is approximately five times as heavy as the cost per mile borne by local trucks, the taxes are plainly discriminatory." The Court stated that "[u]nder our consistent course of decisions in recent years a state tax that favors in-state business over out-of-state business for no other reason than the location of its business is prohibited by the Commerce Clause." 107 *S.Ct.* at 2841 [citation omitted].

The State contends that *Scheiner* establishes a new principle of law because flat taxes had been held to be constitutional in *Capital Greyhound Lines v. Brice*, 339 *U.S.* 542, 70 *S.Ct.* 806, 94 *L.Ed* 1053 (1950); *Aero Mayflower Transit Corp. v. Board of Railroad Comm'rs*, 332 *U.S.* 495, 68 *S.Ct.* 167, 92 *L.Ed* 99 (1947), and *Aero Mayflower Transit Co.*

v. Georgia Public Service Comm'n, 295 *U.S.* 285, 55 *S.Ct.* 709, 79 *L.Ed* 1439 (1935). The flat taxes in these three cases, decided between 1935 and 1950, were upheld on the ground that they were taxes on the privilege of using the State's highways, not on the privilege of engaging in interstate commerce. The *Scheiner* Court stated that "the distinction between a tax on the privilege of using a State's highways and a tax on the privilege of engaging in interstate commerce was also dispositive in *Spector Motor Service, Inc. v O'Connor*, 340 *U.S.* 602, 71 *S.Ct.* 508, 95 *L.Ed* 573 (1951). . . . " *Scheiner* at 107 *S.Ct.* 2846.

The *Scheiner* Court stated:

> In our more recent decisions we have rejected this somewhat metaphysical approach to the Commerce Clause that focused primarily on the character of the privilege rather than the practical consequences of the tax. In 1977, while we recognized that we had invalidated privilege taxes on in-state activity deemed to be part of interstate commerce, we also noted that we had 'moved toward a standard of permissibility of state taxation based upon its actual effect rather than its legal terminology'. *Complete Auto Transit, Inc. v. Brady*, 430 *U.S.* at 281, 97 *S.Ct.* at 1080. 107 *S.Ct.* at 2846.

The *Scheiner* Court stated further that *Complete Auto Transit* had overruled *Spector* and had rejected the concept that interstate commerce is immune from state taxation. The Court stated:

> In ruling that the theoretical underpinnings of this rule had been eroded, we necessarily called into question the future vitality of earlier cases that had upheld facially neutral flat taxes

> against challenges premised on the rule of immunity for interstate commerce. Unsuccessful challenges had then been turned away on the theory that the State was not taxing the conduct of interstate commerce but instead was taxing a unitary, formally defined privilege that was sometimes part of intrastate commerce and sometimes part of interstate commerce. Now that it has been firmly established that interstate commerce as such has no immunity from state taxation, it is no longer appropriate to uphold a flat tax merely because the particular formula by which its charges are reckoned extends the same nominal privilege to interstate commerce that it extends to in-state activities. Such formalism 'merely obscures the question whether the tax produces a forbidden effect.' 107 *S.Ct.* at 2846.

Even if *Complete Auto Transit* did not specifically overrule the *Greyhound* and *Aero Mayflower* cases of 1935, 1947 and 1950, as Justice O'Connor indicates in her dissent, in which the Chief Justice and Justice Powell joined, the invalidity of flat taxes which discriminate as a matter of practical effect was clearly foreshadowed by *Complete Auto Transit*.

Justice O'Connor, referring to the *Greyhound* and *Aero Mayflower* cases, states: "These cases were apparently cited with approval as recently as *Massachusetts v. United States*, 435 *U.S.* 444, 463-464, 98 *S.Ct.* 1153, 1165-1166, 55 *L.Ed*2d 403 (1978), and *Evansville-Vanderburgh Airport Authority District v. Delta Air Lines, Inc.*, 405 *U.S.* 707, 715-717, 92 *S.Ct.* 1349, 1354-1355, 31 *L.Ed.*2d 620 (1972)." However, defendants' reliance on *Massachusetts* or *Evansville-Vanderburgh* for the broad proposition that they

explicitly validated flat taxes after the United States Supreme Court decision in *Complete Auto* is misplaced.

The issue in *Massachusetts* was not whether a state tax unduly burdens interstate commerce, as in *Complete Auto Transit*, but whether a federal annual registration tax on civil aircraft that fly in the air space of the United States violates the state's immunity from federal taxation. In *Massachusetts*, the United State Supreme Court stated explicitly that flat taxes will be sustained against claims based on the Commerce Clause so long as such taxes "(1) do not discriminate against interstate commerce, (2) are based on some fair approximation of use, and (3) are not shown to be excessive, in relation to the cost of the benefits conferred." *Massachusetts, supra*, 98 *S.Ct.* at 1166.

The flat tax imposed by the federal government as part of the comprehensive program to recoup the cost of federal aviation programs was found to be non-discriminatory. The Supreme Court applied the three-prong test of *Evansville-Vanderburgh*, but substituted "state function" for "interstate commerce" and said a state can have no objection to a federal revenue measure "[s]o long as the charges do not discriminate against state functions, are based on a fair approximation of use of the system, and are structured to produce revenues that will not exceed the total cost to the federal government of the benefits to be supplied." 98 *S.Ct.* at 1167. Thus, the Supreme Court's analysis of a flat tax in *Massachusetts* was entirely consistent with the principles articulated in *Complete Auto Transit*.

Evansville-Vanderburgh was decided in 1972, prior to *Complete Auto Transit*. *Evansville-Vanderburgh* held constitutional a $1 use and service charge for each deplaning passenger, on the ground that the fee did not discriminate against interstate commerce.

Defendant asserts that, prior to *Scheiner*, no Supreme Court precedent suggested that a facially non-discriminatory tax would have to pass the "internal consistency" test. Under this test, the tax must be of a kind that, if applied by every jurisdiction, would not result in impermissible interference with free trade. However, the "internal consistency" test is but one way of analyzing the practical effects of the state tax. It would make no sense for the Court to apply the internal consistency test in the *Massachusetts* case because it involved a federal tax, which is applied to all 50 states. However, the decision in *Massachusetts* was based on consideration of the practical effect of the tax, and was held to be non-discriminatory. That Court stated: "the present scheme nevertheless is a fair approximation of the cost of the benefits each aircraft receives." 98 *S.Ct.* at 1167. It cannot be said that the application of the "internal consistency" test in *Scheiner* represented a new principle of law which was not foreshadowed by prior decisions. Rather, it was a specific application of principles articulated by the Supreme Court in *Complete Auto* and the cases that followed it.

Defendant's assertion that the New Jersey Legislature acted in reliance on the *Greyhound* and *Aero Mayflower* cases must be viewed in light of the Legislature's Joint Resolution, which condemned the Pennsylvania axle tax because it caused "great hardship for trucks registered in New Jersey and was 'highly inequitable' inasmuch as the

burden falls upon truck owners who are not resident in Pennsylvania." *Joint Resolution No. 10,* approved and effective June 29, 1983. The Resolution asked Governor Kean to request the Governor and Legislature of Pennsylvania to reconsider the axle tax, with a view to its suspension or repeal.

In summary, it is apparent that in 1984 the Legislature was not justified in relying on the *Greyhound* and *Aero Mayflower* cases, decided between 1935 and 1950, to permit enactment of a discriminatory flat tax. A distinction may be made between discriminatory and nondiscriminatory flat taxes. These three cases upheld discriminatory flat taxes on the ground that those taxes were imposed not on interstate commerce but on the privilege of using the roads of the state. In 1977, *Complete Auto Transit* made it clear that a state could tax interstate commerce but could not discriminate against interstate commerce. *Evansville-Vanderburgh,* decided before *Complete Auto Transit,* and *Massachusetts,* decided after *Complete Auto Transit,* did not validate discriminatory flat taxes. They upheld flat taxes which they determined were not discriminatory. It is clear that the contention that the State relied on existing law in 1984 to justify a tax which obviously discriminated against interstate commerce is misplaced.

I find that the decision of the United States Supreme Court in *Scheiner,* which invalidated a flat tax, was, at the very least, clearly foreshadowed by *Complete Auto Transit.*

I next turn to the history of the decal fee, its purpose and effect. Although the decal fee has been a part of our motor-carrier taxing scheme since 1963, it was not until

1984 that the fee was substantially increased to an amount which, at that time, was the highest in the nation. When the decal fee was increased in 1984, plaintiffs promptly instituted an action contesting it. The $25 decal fee thus did not have the longevity of the ETT, nor can we say, as the Court did in *Salorio*, that the taxpayers suffered no financial harm.

I find that the anti-discrimination principles of the Commerce Clause will be furthered and not retarded by retroactive application of the determination of unconstitutionality of the decal fee. I find, in part, that such action is appropriate because its effect will be to discourage further enactment of constitutionally invalid transportation-related taxes.[2] It is often difficult for interstate business to contest State taxes on Commerce Clause grounds. When such challenges are made successfully but refunds are denied, legislatures are emboldened to enact taxes that favor local interests at the expense of out-of-state interests, and legitimate challenges are discouraged.

With respect to equitable aspects, the State contends that there is no measurable economic harm to the plaintiffs because the decal fee is small compared to other costs of operating over the highways of New Jersey, and because its cost is passed on to the consumer. Plaintiffs and defendant each submitted reports of economist experts who opined on the "pass on" of decal fees to

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[2] *See Private Truck Council v. State*, 111 *N.J.* 214 (1988); *Continental Trailways v. Director, Div. of Motor Vehicles*, 102 *N.J.* 526 (1986), and *Salorio v. Glaser, supra*, as examples of transportation-related taxes which have been held to violate constitutional requirements.

consumers. From the evidence submitted by these two economists, I am unable to conclude that, under the prevailing market conditions, motor carriers and owner-operators are able to completely or even substantially shift the incidence of the New Jersey decal fee forward to their customers. Trucking competes in the general freight transportation market with other transportation modes (rail, air and water) which are not subject to the decal fee. Therefore, truckers cannot unilaterally raise prices without losing business to their non-taxed competitors. Even if trucking operated in an exclusive market, the supply of trucking services in relation to demand would not decrease sufficiently in response to the decal fee to allow a shift of the decal fee to customers. During the period 1984-1987, deregulation of the trucking industry caused an increase in competition because a substantial number of new carriers entered the market. This increased competition also acted to prevent a pass on of the decal fee. Motor carriers are not flexible enough to cease serving customers in or cease driving through New Jersey in response to the relatively small decal fee in relation to other costs.

For these reasons, it is likely that there was no substantial pass-on of the decal fee to customers, and any shift to consumers is impossible to quantify. Therefore, I cannot conclude that plaintiffs will receive a windfall if a refund is granted. As between the State, which enacted a tax which was unconstitutional, and the taxpayers who were forced to pay this tax, the latter have the superior equitable claim.

I find, therefore, under the principles of the *Chevron v. Huson* case, that the decision in *Scheiner* did not

constitute "a clear break" with past law, that legislators will be dissuaded from enacting legislation which discriminates against interstate commerce by the granting of a refund in this case, and that equitable considerations require that the determination of invalidity of the decal fee be applied retroactively, not prospectively.

I also note that this is consistent with the remedy granted by the Appellate Division in *Private Truck Council v. State*, 221 *N.J. Super.* 89 (App. Div. 1987), aff'd 111 *N.J.* 214 (1988), where a refund was ordered, and is consistent with and ameliorative of the agreement entered into between plaintiffs and the State at the inception of this litigation, where the taxpayers gave up their right to seek a preliminary injunction in exchange for "the State having determined that the volunteer principle should not be invoked and that a remedy to recover the fees should be applicable to the extent that all or any portion of such fees are declared to be invalid." In their stipulation, the parties agreed that "should plaintiffs ultimately prevail on the merits in this action, one of the remedies for the recovery of taxes or fees improperly collected will be applicable and may be invoked by the plaintiffs." This court had previously denied plaintiffs' motion to be permitted to pay taxes to an escrow fund to assure the availability of funds for, and the right to receive, refunds should the statute be declared unconstitutional. The court denied that motion, permitting the filing of a refund claim on behalf of the class and stating that that remedy was a sufficient substitute for the escrow fund.

II

The State asks that if a refund of the decal fee is granted to plaintiffs, the refund be limited to $24, with $1 of the fee to be retained by the State to cover the cost of administration. This would require the court to rewrite the statute to provide that the unconstitutional decal fee is $24 in amount and that there is, in addition, a $1 administrative fee which may be constitutional. I find it inappropriate, under the circumstances, for this court to rewrite the statute. I find it proper for a trial court to follow the dictates of the Supreme Court and refrain from judicial restructuring of legislation because policy considerations should, in the first instance, be dealt with by the Legislature rather than the court. *New Jersey Chamber of Commerce v. Election Law Enforcement Comm.*, 82 *N.J.* 57, 81 (1980); *State v. Rosenfeld*, 62 *N.J.* 594, 602 (1973). I note that in the year which has elapsed since *Scheiner*, the Legislature has not enacted a substitute decal fee based on the cost of administration.

III

Are plaintiffs entitled to interest or their refunds?

There is no statutory authorization for payment of interest by the State on tax refunds. I therefore reject plaintiffs' contention that interest should be paid on the refunds. This determination will not preclude plaintiffs from contending that, as a part of the distribution plan, a separate interest-bearing fund should be established, from which the refunds will be paid.

IV

Plaintiffs do not contest the $10 temporary permit fee and have submitted no evidence that it is discriminatory. The $10 temporary permit fee is not only a fee for a decal but is in lieu of motor fuels tax. Since there is no issue with respect to this fee, the court makes no decision as to it.[3]

V

The matter of the awarding of counsel fees will be held pending the filing of a detailed attorney fee petition.

VI

A conference will be held with counsel for the purpose of discussing the mechanics of a distribution plan on September 29, 1988 at 2:00 p.m. in the Tax Court Courtroom, Hughes Justice Complex, 7th Floor, Court Wing, Market Street, Trenton, New Jersey.

Plaintiffs' counsel will submit an appropriate order with respect to all of the foregoing.

Very truly yours,

/s/ Lawrence L. Lasser
Lawrence L. Lasser,
P.J.T.C.

LLL:bjd

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[3] I do not regard footnote no. 9 on page 30 of COIDA's brief as sufficient to raise a constitutional question regarding the $10 temporary permit fee or to establish its invalidity.

CAPITAL GAINS CASES	TAX YEARS	DOUBLE
Pre-*ASARCO*		
Atlantic Richfield Co. v. Colorado Department of Revenue, 198 *Col.* 413, 601 *P.*2d 628 (1979)	1969-73	No
W.R. Grace & Co. v. Commissioner of Revenue, 378 *Mass.* 577, 393 *N.E.*2d 330 (1979)	1969	Court reje argument, multiple t for invalid reasonable reasonably
Post-*ASARCO*		
James v. International Telephone & Telegraph Corp. 654 *S.W.*2d 865 (Mo. banc 1983)	1972-73	No
Brunner Enterprises v. Department of Revenue, 452 *So.*2d 550 (Fla. 1984)	1973-74	No
M. Lowenstein Corp. v. South Carolina Tax Comm'n, 298 *S.C.* 93, 378 *S.E.*2d 272 (App. 1989)	1978-81	No
Pledger v. Illinois Tool Works Inc., 306 *Ark.* 134, 812 *S.W.*2d 101 (Ark. 1991) *cert. denied* 112 *S.Ct.* 418 (1991)	1981-83	No
Corning Glass Works, Inc. v. Virginia Dep't of Taxation, 241 *Va.* 353, 402 *S.E.*2d 35 (Va. 1991) *cert. denied* 112 *S.Ct.* 277 (1991)	1983-84	No

AXATION ALLEGED?	HOLDINGS
	Capital gains and interest income received on sale of corporate assets is apportionable income.
ted taxpayer's double taxation " 'speculative concerns with xation' provide insufficient basis ting a tax derived from a apportionment formula applied." *Id.* at 337.	Capital gains income from sale of subsidiary's stock is apportionable income.
	Capital gains income from divestiture of subsidiaries pursuant to a consent decree is not apportionable income.
	After *ASARCO* opinion, court reversed its previous ruling and held that capital gain from an out-of-state sale of bank stock is not apportionable income.
	Capital gains income from repurchase of bonds and interest from the loans are apportionable income.
	Capital gains income from six different capital assets is not apportionable income.
	Capital gains from divestiture of corporate affiliate and interest income are not apportionable income.

Super Valu Stores v. Iowa Dep't of Revenue and Finance, 479 *N.W.*2d 255 (Iowa 1991)	1984	No
DIVIDEND INCOME CASES	TAX YEARS	DOUBLE TA
Post-*ASARCO*		
Philip Morris Inc. v. Director of Revenue, 760 *S.W.*2d 888 (Mo. banc. 1988)	1980-82	No
Jewel Companies, Inc. v. Montana, Dept. of Revenue, No. CT-1985-4 (81 Mont. Tax LEXIS 1990), remanded Montana First Judicial District Court No. BDV-89-294 (Oct. 31, 1991)	1979-83	No
NCR Corp. v. South Carolina, 402 *S.E.*2d 666 (S.C. 1991)	1981-83	No
INTEREST INCOME CASES	TAX YEARS	DOUBLE TA
Pre-*ASARCO*		
Great Lakes Pipe Line Co. v. Commission of Taxation, 272 *Minn.* 403, 138 *N.W.*2d 612, app. dismissed 384 *U.S.* 718 (1965)	1955-59	Yes, Court r argument, " same prope longer a cor
Montgomery Ward & Co. v. Commissioner of Taxation, 276 *Minn.* 479, 151 *N.W.*2d 294 (Minn. 1967)	1955-58	No

Capital gain income is apportionable income.

XATION ALLEGED?

HOLDINGS

Dividend income is not apportionable business income.

State Tax Appeal Board (STAB) held that dividends and capital gains income are apportionable business income. First Judicial District Court remanded case to STAB to evaluate case under proper legal standards as set forth in *ASARCO, Woolworth* and *Container.*

Income payments from licensees and subsidiaries is apportionable business income.

XATION ALLEGED?

HOLDINGS

jected double taxation possibility of taxation of the ty by more than one state is no stitutional objection." *Id.* at 619.

Interest income from short term government obligations and commercial paper is apportionable business income.

Interest income from short term investments is apportionable business income.

INTEREST INCOME CASES	TAX YEARS	DOUBLE T
Champion International Corp. v. Bureau of Revenue, 88 *N.M.*411, 540 *P.*2d 1300 (1975)	1972	No
Qualls v. Montgomery Ward & Co., 266 *Ark.* 207, 585 *S.W.*2d 18 (1979) [overruled by *Pledger v. Illinois Toolworks*, 812 *S.W.*2d 101 (1991)]	1972-74	Yes, court r argument, nor the com precision in
Post-*ASARCO*		
Lone Star Steel Co. v. Dolan, 668 *P.*2d 916 (Colo. *en banc* 1983)	1970-73	Yes, court r argument, t burden of s a fair appor
Comptroller v. Armco, Inc., 70 *Md. App.* 403, 521 *A.*2d 785 (Md. App. 1987)	1978	No
NCR Corp. v. Comptroller of the Treasury, 313 *Md.* 118, 544 *A.*2d 764 (Md. 1988)	1976-77	No
NCR Corp. v. Comm'r of Revenue, 438 *N.W.*2d 86 (Minn. 1989), *cert. denied* 493 *U.S.* 845 (1990)	1977-81	Yes, court re possible dou taxes subsid countries tax constitutiona state to appl because the

a XATION ALLEGED?	HOLDINGS
	Interest income from the short-term investment of excess capital is apportionable business income.
jected double taxation neither the due process clause merce clause requires total multi-state taxation." *Id.* at 31.	Interest income from loans to out-of-state corporate affiliates is apportionable business income.
ected double taxation xpayer has not satisfied its owing that there has not been ionment. *Id.* at 927.	Interest income from short term loans and dividends received from subsidiaries are apportionable income.
	Court of Special Appeals remanded case to tax court for a finding of whether Armco's business activity in generating a loan to an unrelated corporation is unitary with Armco's business in Maryland.
	Interest income from investments of surplus funds in short term certificates of deposit, commercial paper, government notes and municipal bonds is apportionable income.
ected taxpayer's argument that ble taxation exists if Minnesota aries' income and foreign the same income because analysis does not require the a different formula simply isk may be lower. *Id.* at 94.	Interest income payments from licensees and subsidiaries is apportionable income.

INTEREST INCOME CASES	TAX YEARS	DOUBLE
American Home Products Corp. v. Limbach, 49 *Ohio St.* 3d. 158, 551 *N.E.*2d 201, *cert. denied* 111 *S.Ct.* 63 (1990)	1980-83	No
Williams Companies v. Director of Revenue, 799 *S.W.*2d 602 (Mo. 1990) *cert. denied* 111 *S.Ct.* 2916 (1991)	1982-84	No

NEW JERSEY CASES	TAX YEARS	TAX AMO
Pre-*ASARCO*		
F.W. Woolworth v. Director, Division of Taxation, 45 *N.J.* 466, 213 *A.*2d 1 (1965)	1959	$100,000
Post-*ASARCO*		
Silent Hoist & Crane v. Director, Division of Taxation, 100 *N.J.* 1, 494 *A.*2d 775 (1985), *cert. denied* 474 *U.S.* 995 (1985)	1971-74	$49,341
International Paper Co. v. Director, Division of Taxation, 11 *N.J. Tax* 147 (Tax Ct. 1990 *en banc*) aff'd N.J. Super. Ct. App. Div., No. A-5138-89T5 (May 13, 1991), certif. denied N.J. Sup. Ct., No. 33,784 (Oct. 16, 1991)	1981-82	Refund Cla

4a

AXATION ALLEGED?

HOLDINGS

Interest income from short-term investment securities is not apportionable income when not used in the business.

Interest income on inter-corporate loans and capital gains from preferred stock are apportionable income.

UNT

HOLDINGS

Value of foreign subsidiaries is includable in the net worth tax base and the income from foreign subsidiaries is includable in the net income tax base.

Portfolio investment income is apportionable income.

n of $159,526

Capital gain and interest income from sale of wholly owned subsidiary is apportionable income. Capital gain income realized on sale of minority stock interest is not apportionable income.

NEW JERSEY CASES	TAX YEARS	TAX AMOU
Mobil Oil Corp. v. Director, Division of Taxation, 11 *N.J. Tax* 344 (Tax Ct. 1990), aff'd *per curiam*, N.J. Super. Ct., No. A-2326-90T5 (March 4, 1992)	1980	$3,686,582
American Home Products Corp. v. Director, Div. of Taxation, 11 *N.J. Tax* 287 (Tax Ct. 1990) appeal pending N.J. Super Ct., A-4316-90T3	1979-81	$415,873
Bendix Corp. v. Director, Division of Taxation, 10 *N.J. Tax* 46 (Tax Ct. 1988) aff'd 237 *N.J. Super.* 328, 568 *A.*2d 59 (App. Div. 1989), 125 *N.J.* 20, 592 *A.*2d 536 (1991), *cert. granted sub nom. Allied Signal, Inc. v. Director, Division of Taxation*, 112 *S.Ct.* 632 (1991)	1981	Refund Clair

NT

of $2,056,645

HOLDINGS

Capital gain income from 17% interest in oil producing company is not apportionable income.

Interest income from short term investment of working capital is apportionable only to extent that income and underlying investments were used in taxpayer's business; income from diversified, minority stock investments is not apportionable income.

Capital gains from 20% stock investment and from wholly owned subsidiary and related interest income are apportionable income.

Supreme Court, U.S.
FILED
APR 17 1992
OFFICE OF THE CLERK

No. 91-615

In the Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation, PETITIONER

v.

DIRECTOR, DIVISION OF TAXATION, RESPONDENT

On Writ of Certiorari to the Supreme Court of New Jersey

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TABLE OF CONTENTS

	Page
INTRODUCTION	1
I. ADOPTION OF NEW JERSEY'S EVERY-THING-IS-APPORTIONABLE REGIME WOULD JETTISON THE MOST BASIC CONSTITUTIONAL RESTRAINT ON THE EXERCISE OF STATE TAX POWER AND WOULD EFFECTIVELY OVERRULE A CENTURY OF THIS COURT'S PRECEDENTS	1
II. ADOPTION OF TWO DIFFERENT STANDARDS OF APPORTIONABILITY DEPENDING ON WHETHER INCOME IS EARNED BY A SINGLE CORPORATION OR BY A MULTI-CORPORATE ENTERPRISE WOULD ENSHRINE FORM OVER SUBSTANCE AS A PRINCIPLE OF CONSTITUTIONAL LAW	5
III. NEW JERSEY'S PROPOSED REGIME WOULD VIOLATE THE CONSTITUTIONAL PRINCIPLE BARRING ALLOCATION AND APPORTIONMENT OF THE SAME INCOME AND WOULD SPAWN UNACCEPTABLE LEVELS OF MULTIPLE TAXATION	8
IV. THE CONSTITUTIONAL REGIME ESPOUSED BY NEW JERSEY AND ITS *AMICI* IS ESSENTIALLY A REGIME WITH NO MEANINGFUL RESTRAINTS ON STATE TAX POWER	12
V. IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE DECISION SHOULD NOT BE RETROACTIVE	15
CONCLUSION	20

TABLE OF AUTHORITIES

Cases **Page**

Adams Express Co. v. Kentucky, 166 U.S. 171 (1898) 1
Adams Express Co. v. Ohio, 165 U.S. 194 (1897) .. 5
American Home Prods. Corp. v. Limbach, 551 N.E.2d 201 (Ohio), *cert. denied*, 111 S. Ct. 63 (1990) 11
ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982) ..... *passim*
Brunner Enters. v. Department of Revenue, 452 So.2d 550 (Fla. 1984) 11
Champion Int'l Corp. v. Bureau of Revenue, 540 P.2d 1300 (N.M. 1975) 11
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 15, 16, 17, 20
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 6, 15
Comptroller v. Armco, Inc., 521 A.2d 785 (Md. Ct. Spec. App. 1987) 11
Connecticut General Life Ins. Co. v. Johnson, 303 U.S. 77 (1938) 3
Container Corporation of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 2, 5, 16, 17
Corning Glass Works, Inc. v. Virginia Dept. of Taxation, 402 S.E.2d 35 (Va.), *cert. denied*, 112 S. Ct. 277 (1991) 11
Fargo v. Hart, 193 U.S. 490 (1904) 3, 4, 18
F.W. Woolworth Co. v. Taxation & Revenue Department, 458 U.S. 354 (1982) ..... *passim*
Great Lakes Pipe Line Co. v. Commissioner of Taxation, 138 N.W.2d 612 (Minn. 1965), *app. dismissed*, 384 U.S. 718 (1966) 10
James v. International Tel. & Tel. Corp., 654 S.W.2d 865 (Mo. 1983) 11
James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991) 19
Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) 9

TABLE OF AUTHORITIES—Continued

Page

Jewel Companies, Inc. v. Department of Revenue, No. CT-1985-4 (1990 Mont. Tax LEXIS 81), remanded Montana First Judicial District Court No. BDV-89-294 (Oct. 31, 1991) 11
Lone Star Steel Co. v. Dolan, 668 P.2d 916 (Colo. 1983) 10
M. Lowenstein Corp. v. South Carolina Tax Comm'n, 378 S.E.2d 272 (S.C. Ct. App. 1989) 11
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) 1, 6, 10
Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978) 8, 9
NCR Corp. v. Commissioner of Revenue, 438 N.W.2d 86 (Minn. 1989), *cert. denied*, 493 U.S. 845 (1990) 10
NCR Corp. v. Comptroller of the Treasury, 544 A.2d 764 (Md. 1988) 11
NCR Corp. v. South Carolina Tax Comm'n, 402 S.E.2d 666 (S.C. 1991) 11
Oklahoma v. Wells, Fargo & Co., 223 U.S. 298 (1912) 3
Philip Morris, Inc. v. Director of Revenue, 760 S.W.2d 888 (Mo. 1988) 11
Pledger v. Illinois Tool Works, 306 Ark. 134, 812 S.W.2d 101, *cert. denied*, 112 S. Ct. 418 (1991) 5, 10
Qualls v. Montgomery Ward & Co., 585 S.W.2d 18 (Ark. 1979) 10
Standard Oil Co. v. Peck, 342 U.S. 382 (1952) 9
Thomas v. Washington Gas Light Co., 448 U.S. 261 (1980) 15
Wallace v. Hines, 253 U.S. 66 (1920) 3, 18
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940) 2
W.R. Grace & Co. v. Commissioner of Revenue, 393 N.E.2d 330 (Mass. 1979) 10

Other Authorities

Eliot, T.S., *The Complete Poems and Plays* (1952) 7
1 Multistate Corporate Income Tax Guide (CCH) (1992) 6, 7, 8, 9

REPLY BRIEF OF PETITIONER ON REARGUMENT

INTRODUCTION

The position New Jersey has embraced in this case is nothing short of extraordinary. It would permit a state to tax an apportioned share of any income earned by a taxpayer even if the state has no connection with the activities that produced the income. It would define a unitary business merely by reference to ownership despite this Court's century-old admonition that a unitary business involves "something more than a mere unity of ownership." *Adams Express*, 165 U.S. at 222. At the same time, it would retain the traditional unitary business standard for combining the income of multicorporate enterprises, thereby allowing corporate form to dictate the substance of the constitutional limits on state tax power. And it would sanction multiple taxation resulting from allocation and apportionment of the same income, which this Court has explicitly condemned on the ground that "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate." *Mobil*, 445 U.S. at 444.

Adoption of New Jersey's proposed regime would thus abandon the most fundamental constitutional restraints on state tax power and would foster the very evils that those restraints were designed to prevent. The Court should therefore reject New Jersey's effort to rewrite the constitutional law of state taxation and should reaffirm the sound constitutional principles underlying *ASARCO* and *Woolworth*.

I. ADOPTION OF NEW JERSEY'S EVERYTHING-IS-APPORTIONABLE REGIME WOULD JETTISON THE MOST BASIC CONSTITUTIONAL RESTRAINT ON THE EXERCISE OF STATE TAX POWER AND WOULD EFFECTIVELY OVERRULE A CENTURY OF THIS COURT'S PRECEDENTS

There is no blinking the astonishing proposition that New Jersey has advanced before this Court:

> The constitutional principle we propose is simply that when a nondomiciliary state seeks to impose its corporate net income tax on a single multistate taxpayer, . . . the . . . state has a sufficient connection with the taxpayer to include all its income in the apportionable tax base.

N.J. Rearg. Br. 27. This proposition—that "[t]he unitary business is congruent with the single corporation" (*id.*)—ignores the most fundamental limitation on state tax power and runs roughshod over scores of this Court's decisions.

First, as even New Jersey recognizes, a state's power to tax depends on the "protection, opportunities, and benefits" (*J.C. Penney*, 311 U.S. at 444) provided to the taxpayer's "*activities* in the taxing state." N.J. Rearg. Br. 9 (emphasis supplied). When a state seeks to include income from a taxpayer's out-of-state activities in its apportionable tax base, this means that "the out-of-state *activities* of the purported unitary business [must] be related in some concrete way to the in-state *activities*." *Container*, 463 U.S. at 166 (emphasis supplied). The mere fact that a corporation is subject to a state's taxing power tells us nothing about the connection of that corporation's out-of-state activities to the taxing state.[1] New Jersey's proposed test of unitariness therefore disregards the requirements of the Commerce and Due Process Clauses.[2]

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[1] The threshold nexus that subjects a taxpayer to the state's tax jurisdiction has always been viewed as discrete from the need for a connection between a taxpayer's in-state and out-of-state activities sufficient to consider the out-of-state activities in determining the taxpayer's apportionable tax base. *See, e.g., Container*, 463 U.S. at 165-66 (discussing threshold nexus question and, "[*i*]*n addition*," unitary business requirement (emphasis supplied)).

[2] Under New Jersey's approach, for example, if a single corporation owned a gambling casino in Nevada and a peanut farm in Georgia, and the operations of the two businesses had nothing to do with one another, Georgia could nevertheless include the income from the gambling casino in the taxpayer's apportionable tax base even though gambling is illegal in Georgia. Can it possibly be asserted with a straight face that Georgia has provided "opportuni-

Second, for the past 100 years the law has been clear that the mere jurisdictional presence of a taxpayer in a state does not justify the state's power to include in the taxpayer's apportionable tax base everything it owns or earns. *See, e.g., Fargo, Wallace,* and *Wells Fargo,* discussed in Allied-Signal Rearg. Br. at 11-12; *Connecticut General Life Ins. Co. v. Johnson,* 303 U.S. 77 (1938). Indeed, had the law been otherwise, the need for the unitary business principle—as a limited exception to the rule that states may not look outside their borders in exercising their tax power—would never have arisen. Once the state's jurisdiction over the taxpayer had been established, the apportionability of its tax base would have followed as a matter of course. That is not and never has been the law.

New Jersey's suggestion that its proposed rule would be consistent with the Court's prior cases (N.J. Rearg. Br. 30-33) is therefore preposterous. New Jersey's effort to distinguish the railroad property cases, which laid the constitutional foundation for the unitary business principle applied in the Court's net income tax cases (Allied-Signal Rearg. Br. 7-10), proceeds on the false premise that those cases involved "*tangible* property that can be seen and sited to a particular location." N.J. Rearg. Br. 31, n.20 (emphasis supplied); see also *id.* at 10. In fact, those cases involved taxation of *intangible* property (in *Fargo* securities, in *Wells, Fargo* bonds, in *Wallace* bonds (see Allied-Signal Br. 11-12)), and the principles adopted in those cases govern the apportionablity of income from such property, as the Court properly recognized in *ASARCO* and *Woolworth. ASARCO,* 458 U.S. at 328; *Woolworth,* 458 U.S. at 363.

New Jersey contends that, prior to the Court's decisions in *ASARCO* and *Woolworth,* "the Court applied the unitary business principle to the activities of a single corporation and invariably concluded that the single cor-

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ties, protections, and benefits" to an unrelated, out-of-state business which cannot legally be conducted in Georgia?

poration's business was indivisible." N.J. Rearg. Br. 31. This observation hardly advances New Jersey's strained attempt to square its everything-is-apportionable rule with the Court's precedents. Every one of the Court's earlier decisions involved taxpayers that were indisputably carrying on a unitary business under the familiar rule requiring an "organic connection" (*Fargo*, 193 U.S. at 499) between the taxpayer's in-state and out-of-state activities. See Allied-Signal Br. 20 n.9. Indeed, the Court's analysis in all of those cases—its search for functional ties between the corporate taxpayers' in-state and out-of-state activities—would have been wholly unnecessary had New Jersey's position been the law. Moreover, in none of those cases was any issue raised as to the apportionability of intangible income derived from activities that had no "organic connection" (*Fargo*, 193 U.S. at 499) to the taxpayer's operations in the state. New Jersey's frontal assault on the existing constitutional regime governing state taxation of multistate corporations therefore goes far beyond the overruling merely of *ASARCO* and *Woolworth*.

In fact, New Jersey's specific quarrel with the Court's opinions in those cases—that they required a unitary relationship between the payee and the payor of investment income as the exclusive test of apportionability (N.J. Rearg. Br. 7-11)—involves a point that was peripheral to their analysis of the unitary business principle and that is not even at issue here. See Allied-Signal Rearg. Br. 5 n.1. By directing its fire at the payor-payee language in *ASARCO* and *Woolworth*, New Jersey has seized on what may have been the Court's doctrinal foot fault in those cases as a pretext for dismantling the entire constitutional framework that has restrained state taxing power for over a century. The Court could easily address New Jersey's apparent concerns with *ASARCO* and *Woolworth* by explicitly recognizing the apportionability of income from intangible assets that are functionally related on a current basis to the taxpayer's trade or busi-

ness in the taxing state.[3] There is no warrant for the Court to go any further. Moreover, it is plain that Bendix's gain from the sale of its ASARCO stock would not be apportionable under such a revised interpretation of *ASARCO* and *Woolworth* because there is not—and there could not be—any claim here that Bendix employed the ASARCO stock in Bendix's day-to-day operations as working capital or used it as an asset serving an operational function under the *Corn Products* doctrine.

II. ADOPTION OF TWO DIFFERENT STANDARDS OF APPORTIONABILITY DEPENDING ON WHETHER INCOME IS EARNED BY A SINGLE CORPORATION OR BY A MULTICORPORATE ENTERPRISE WOULD ENSHRINE FORM OVER SUBSTANCE AS A PRINCIPLE OF CONSTITUTIONAL LAW

While New Jersey would ignore this Court's teaching that a unitary business involves "something more than a mere unity of ownership" (*Adams Express*, 165 U.S. at 222) for purposes of determining the apportionability of a single corporation's income, it would nonetheless retain the traditional unitary business principle for purposes of determining the apportionability of the income of a combined group of corporations. N.J. Rearg. Br. 33-34. New

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[3] This would hardly be breaking new ground. See *Container*, 463 U.S. at 180 n.19. Indeed, most courts have had little problem in drawing this line. See Allied-Signal Br. 28 n.12; Allied-Signal Rearg. Br. 16 n.5. Insofar as there is any substance to New Jersey's complaint that courts have had "difficulty . . . in trying to apply the *ASARCO/Woolworth* payor-payee test in a coherent fashion" (N.J. Rearg. Br. 12-13 n.4), it is only that some courts may have taken this Court too literally in requiring a unitary relationship between the payor and the payee of intangible income as the exclusive test of the apportionability of such income. *See, e.g., Pledger v. Illinois Tool Works*, 306 Ark. 134, 812 S.W.2d 101, *cert. denied*, 112 S. Ct. 418 (1991). The Court's explicit acknowledgement of the apportionability of income from intangible assets functionally related on a current basis to the taxpayer's trade or business in the taxing state would eliminate any alleged confusion.

Jersey's approach would create the worst of both worlds: It would elevate form over substance for states like New Jersey, which strictly respect the separate corporate entity for tax purposes (N.J. Rearg. Br. 34 n.22), and it would leave intact what New Jersey labels a system based on "elusive legal concepts and lengthy factual records" (N.J. Rearg. Br. 42) for the 30 states with combined reporting provisions. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 185 (1992).

The Court has made clear that the constitutionality of state taxes under the Due Process and Commerce Clauses ultimately turns on the "practical effect of a challenged tax" (*Mobil*, 445 U.S. at 443) and on "economic realities." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Accordingly, when analyzing the apportionability of income, the Court has eschewed form as a touchstone of constitutional analysis because "the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise." *Mobil*, 445 U.S. at 440. It is the "underlying economic realities of a unitary business," not the form in which it is carried on, that "affect[s] the apportionability of income." *Id.* at 441.

New Jersey's proposed taxing scheme flies in the face of these principles. To return to the example of an Illinois-domiciled corporation that operates a beauty parlor business in New Jersey and an unrelated parking lot business in California, assume that the California parking lot business is operated through a wholly-owned subsidiary. New Jersey acknowledges that it would lack the constitutional power to include the parking lot income in a combined report because there is no unitary relationship between the parking lot business and the beauty parlor business. If, however, the parking lot subsidiary were dissolved and its operations carried on by its parent, New Jersey's constitutional power would miraculously expand to include the parking lot income in the apportionable tax base because the income was all earned by a

single corporation, although the "underlying economic realities" (*id.*) remain identical.

Indeed, New Jersey's *amici* recognize the wholly formal character of the constitutional line New Jersey would draw by observing that "[a] taxpayer can control its tax exposure in New Jersey by the simple expediency of establishing wholly owned subsidiaries." Cal. Ami. Rearg. Br. 24. Thus all Bendix "had to do to avoid taxation of the disputed gain in this case was to move the ASARCO interest out into a separately organized corporation that had no nexus with New Jersey." MTC Ami. Rearg. Br. 23. While New Jersey is free as a matter of state law to adopt a scheme in which form prevails over substance, and to deny itself the right to tax constitutionally apportionable income, it cannot force feed its scheme to taxpayers by the "simple expediency" of assuming that all income earned by a single corporation is apportionable. Constitutional restraints on state tax power do not expand and contract based on economically meaningless changes in corporate organization.

This elevation of form over substance also belies New Jersey's assertion that *ASARCO* and *Woolworth* should be overruled because the definitions they draw have proven difficult to administer; under New Jersey's own approach, *ASARCO* and *Woolworth* would continue to govern in the 30 states with combined reporting provisions. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 185 (1992). Those states will continue to bear "the expense and uncertainty of litigating and relitigating the unitary business issue, with each case turning on its peculiar facts." N.J. Rearg. Br. 41-42. Indeed, New Jersey might find itself pressured to adopt combined reporting if corporate taxpayers, with an expanded New Jersey tax base tied to corporate form, followed the advice of New Jersey's *amici* and altered the corporate form of their New Jersey operations to minimize their tax liability. We would then "arrive where we started and know the place for the first time." T.S. Eliot, *Little Gidding*, in *The Complete Poems and Plays* 145 (1952).

III. NEW JERSEY'S PROPOSED REGIME WOULD VIOLATE THE CONSTITUTIONAL PRINCIPLE BARRING ALLOCATION AND APPORTIONMENT OF THE SAME INCOME AND WOULD SPAWN UNACCEPTABLE LEVELS OF MULTIPLE TAXATION

New Jersey concedes that its everything-is-apportionable regime will inevitably give rise to multiple taxation if other states' laws, which generally allocate nonbusiness income to a single state (1 Multistate Corporate Income Tax Guide (CCH) ¶ 167 (1992); UDITPA §§ 5-8), are permitted to stand. N.J. Rearg. Br. 38. Faced with the Hobson's choice of impugning the constitutionality of most other states' laws, see Allied-Signal Rearg. Br. 27-29, or defending a system that will necessarily spawn widespread multiple taxation, New Jersey opted for the latter. As we demonstrate below, however, the multiple taxation resulting from New Jersey's proposed regime is constitutionally indefensible.

New Jersey fails even to mention this Court's precedents that establish the rule that precludes a domiciliary state from allocating to itself 100% of a tax base which other states have power to tax on an apportioned basis. See Allied-Signal Rearg. Br. 28. It relies instead on *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978) (N.J. Rearg. Br. 39), which held that the Commerce Clause tolerates, as the price of federalism, "some risk of duplicative taxation" occasioned by inconsistent apportionment mechanisms. 437 U.S. at 278. The risk the Court found tolerable in *Moorman*, however, was qualitatively and quantitatively different from the risk of multiple taxation created by New Jersey's proposed constitutional regime, and *Moorman* therefore provides no support for New Jersey's position.

First, all states that use apportionment formulas are attempting to determine the same thing: the share of the taxpayer's income that may be fairly attributed to the taxpayer's in-state activities. The risk of multiple taxation occasioned by the existence of varying apportionment formulas therefore is uncertain and adventitious. Incon-

sistent apportionment formulas may produce taxation of more or less than 100% of a corporation's tax base depending on the particular facts of the taxpayer's business and the particular apportionment formulas employed by the state.[4] By contrast, the risk of multiple taxation occasioned by the existence of inconsistent income attribution methods—allocation and apportionment—is absolute. With one state allocating to itself 100% of a corporation's tax base, apportionment of such income by any other state inexorably causes multiple taxation.

Second, the actuality of multiple taxation occasioned by the existence of inconsistent apportionment formulas, when it in fact occurs, is likely to be minimal, considering that no state is seeking to tax more than its fair share of the taxpayer's tax base and that most states' formulas are substantially similar. See 1 Multistate Corporate Income Tax Guide (CCH) ¶ 146 (1992). By contrast, the actuality of multiple taxation occasioned by allocation and apportionment of the same tax base will almost always be substantial, with the state to which the income is allocated taxing 100% of the taxpayer's income while other states each lay their claim to an apportioned share of the income.

New Jersey's position therefore cannot be reconciled with one of the most basic constitutional restrictions on state taxation of interstate enterprises: that two states cannot tax the same values. *Standard Oil*; *Japan Line*.

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[4] For example, the taxpayer in *Moorman*, an Illinois-based manufacturer selling into Iowa, complained that the application of Iowa's single-factor sales formula, in conjunction with Illinois' standard three-factor formula of property, payroll, and sales, subjected it to taxation on more than 100% of its income from Iowa sales. Iowa would tax all of such income based on sales into Iowa while Illinois would tax a portion of it based on the taxpayer's property, payroll, and sales in Illinois. By the same token, however, an Iowa-based manufacturer selling into Illinois would be subjected to taxation on less than 100% of its income from Illinois sales. Iowa would tax none of such income because there are no Iowa sales while Illinois would tax only a portion of it based on the taxpayer's property, payroll, and sales in Illinois.

It therefore is not surprising that the Court already has flatly rejected New Jersey's position here, declaring that "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate." *Mobil*, 445 U.S. at 444. While acknowledging the power of a domiciliary state to lay "some" tax upon the income of a unitary business conducted in the state, the Court declared that "there is no reason in theory why that power should be exclusive" when the income derives "from a unitary business, part of which is conducted in other States." *Id.* at 445-46. In short, the Court has made clear that it will not tolerate the multiple taxation that could result from "theoretically incommensurate" claims to allocation and apportionment of the same income. *Id.* at 447; Allied-Signal Rearg. Br. 27-29.

Beyond the analytical flaws in New Jersey's defense of multiple taxation, its attempt to downplay the magnitude of the problem on the ground that "allegations of double taxation of intangible income are relatively infrequent" (N.J. Rearg. Br. 38 n.27 (citing Appendix)) is misleading and disingenuous. First, in a number of cases cited by New Jersey, taxpayers in fact did raise issues of multiple taxation.[5] Second, and more significantly, since New Jersey's scheme envisions the apportionment of all income —whether derived from tangible or intangible assets— the citation of cases involving only intangible income does not begin to portray the extent of multiple taxation that would result from New Jersey's approach. For example, if a taxpayer owns real property unrelated to its business

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[5] *See W.R. Grace & Co. v. Commissioner of Revenue*, 393 N.E.2d 330, 337 (Mass. 1979); *Great Lakes Pipe Line Co. v. Commissioner of Taxation*, 138 N.W.2d 612, 619 (Minn. 1965), *appeal dismissed*, 384 U.S. 718 (1966); *Qualls v. Montgomery Ward & Co.*, 585 S.W.2d 18, 31 (Ark. 1979) (overruled by *Pledger v. Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark.), *cert. denied*, 112 S. Ct. 418 (1991)); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916, 927 (Colo. 1983) (*en banc*); *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86, 94 (Minn. 1989), *cert. denied*, 493 U.S. 845 (1990).

operations, most states will allocate the capital gain from the sale of such property to the state where the property is located. *See, e.g.*, UDITPA § 6(a). If, as New Jersey urges, it were constitutionally permissible for states to apportion nonbusiness income from sales of real property located in other states, multiple taxation would inevitably result.[6]

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[6] Even if the Court believed it was relevant to inquire why the issue of double taxation may not have arisen in some of the cases cited by New Jersey in its Appendix, there are good explanations, none of which even remotely justifies the regime of extensive multiple taxation that New Jersey would have this Court endorse. Almost all of the non-New Jersey cases fall into one or both of the following two categories: (a) the laws of the state of commercial domicile did not provide for allocation of the class of income that was at issue, so there was no risk of double taxation, *see James v. International Tel. & Tel. Corp.*, 654 S.W.2d 865 (Mo. 1983) (*en banc*) (New York); *M. Lowenstein Corp. v. South Carolina Tax Comm'n*, 378 S.E.2d 272 (S.C. Ct. App. 1989) (New York); *Corning Glass Works, Inc. v. Virginia Dep't of Taxation*, 402 S.E.2d 35 (Va.), *cert. denied*, 112 S. Ct. 277 (1991) (New York); *Philip Morris, Inc. v. Director of Revenue*, 760 S.W.2d 888 (Mo. 1988) (*en banc*) (New York); *American Home Prods. Corp. v. Limbach*, 551 N.E.2d 201 (Ohio), *cert. denied*, 111 S. Ct. 63 (1990) (New York); *Champion Int'l Corp. v. Bureau of Revenue*, 540 P.2d 1300 (N.M. 1975) (Connecticut); *Comptroller v. Armco, Inc.*, 521 A.2d 785 (Md. Ct. Spec. App. 1987) (Ohio); *NCR Corp. v. Comptroller of the Treasury*, 544 A.2d 764 (Md. 1988) (Ohio); *NCR Corp. v. South Carolina Tax Comm'n*, 402 S.E.2d 666 (S.C. 1991) (Ohio); and/or (b) the taxpayer won on other grounds, so so that the court never had to reach the issue of double taxation. *See James v. International Tel & Tel. Corp.*, 654 S.W.2d 865 (Mo. 1983) (*en banc*); *Corning Glass Works, v. Virginia Dep't of Taxation*, 402 S.E.2d 35 (Va.), *cert. denied*, 112 S. Ct. 277 (1991); *Philip Morris Inc. v. Director of Revenue*, 760 S.W.2d 888 (Mo. 1988) (*en banc*); *Brunner Enters. v. Department of Revenue*, 452 So. 2d 550 (Fla. 1984); *Pledger v. Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark.), *cert. denied*, 112 S. Ct. 418 (1991); *Jewel Companies, Inc. v. Department of Revenue*, No. CT-1985-4 (1990 Mont. Tax LEXIS 81), remanded Montana First Judicial District Court No. BDV-89-294 (Oct. 31, 1991); *American Home Prods. Corp. v. Limbach*, 551 N.E.2d 201 (Ohio), *cert. denied*, 111 S. Ct. 63 (1990).

IV. THE CONSTITUTIONAL REGIME ESPOUSED BY NEW JERSEY AND ITS *AMICI* IS ESSENTIALLY A REGIME WITH NO MEANINGFUL RESTRAINTS ON STATE TAX POWER

What New Jersey wants, in the end, is a regime in which states are free to tax income in any way they please subject only to nominal constitutional restraints. It wants a world in which a state may include all of a nondomiciliary's income in its apportionable tax base without any inquiry into the link between the activities that produced the income and the taxing state. N.J. Rearg. Br. 27. It wants a world in which other states have similar latitude in choosing apportionment methods, including methods that will inevitably result in multiple taxation when employed alongside its own. *Id.* at 40-41. And it wants a world in which such multiple taxation may be imposed with constitutional impunity. *Id.* at 38-40.

New Jersey's *amici* are of the same mind. See Cal. Ami. Rearg. Br.; Conn. Ami. Rearg. Br.; MTC Ami. Rearg. Br. Indeed, in this respect the audacity of the Multistate Tax Commission's (MTC's) brief is remarkable. The MTC is the "administrative arm" of the Multistate Tax Compact, which seeks to "promote uniformity or compatibility of state tax systems . . . and avoid duplicative taxation" (MTC Opening Br. 1-2); the MTC describes as its "central" goal "[f]ostering state tax uniformity." *Id.* at 2-3. Yet the MTC wholeheartedly endorses New Jersey's effort to tax all intangible income on an apportioned basis, despite the inconsistency of New Jersey's position with UDITPA, which the MTC administers, and the duplicative taxation it will inevitably cause.[7]

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[7] While the MTC calls for a "practical, even-handed statement of the unitary business principle," MTC Ami. Rearg. Br. 2, it is later apparent that the "new" unitary business principle permits full apportionment of income from intangibles. *Id.* at 18-23. Although described at one point as a "statutory presumption," it is clear that it is not rebuttable. *Id.* at 21.

The MTC also seeks to justify New Jersey's everything-is-apportionable regime on the ground that New Jersey accepts "the good and the bad of its choice." MTC Ami. Rearg. Br. 22. By "bad" the MTC means that New Jersey has "forego[ne] complaint," permitting non-New Jersey losses to reduce New Jersey income, where a taxpayer incurs such losses from a business segment that "operate[s] distinctly" from the business operating in New Jersey. *Id.*[8] However, our constitutional system is not one in which the unconstitutional extraterritorial taxation of Taxpayer A becomes justifiable because the tax collector undercollects from Taxpayer B.

Finally, the MTC fails in its attempt to define a workable unitary business principle by reference to an amorphous standard of business purpose linking operationally unrelated business activities on the basis of "the existence of management that is organized or poised to ensure that individual business segments operate for the benefit of the integrated whole." *Id.* at 9. This is simply a recycled version of the contentless unitary business standard adopted by the court below and the meaningless "corporate purpose" standard of a unitary business rejected by the Court in *ASARCO* and *Woolworth*. Indeed, it was New Jersey's very inability to articulate a meaningful line based on such unintelligible criteria that induced it to invite the Court to discard the unitary business principle altogether.

It is also worth noting that New Jersey, while acknowledging the "theoretical uncertainty" and "practical problems" that its taxing regime would create with respect to

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[8] The MTC does acknowledge that "in a rare circumstance" there may be different segments in a business that operate distinctly, but this does not change its support of New Jersey even in those circumstances. *Id.* Indeed, in responding to our beauty shop/parking lot hypothetical, which involved two businesses that were as unrelated as we could make them, the MTC could not resist "fighting the hypothetical" by fabricating various "transfer[s] of value" (*id.* at 9) between the businesses that did not in fact exist. *Id.* at 8-9.

fair apportionment, offers the Court no solution to these problems. N.J. Rearg. Br. 37; see Allied-Signal Rearg. Br. 25-27, 31-33. Allied Signal and its *amici* have addressed these problems in detail and have argued that the difficulty in solving them is just one more reason for the Court to maintain the existing constitutional regime for apportioning and allocating corporate income. New Jersey's leave-it-to-another day attitude (N.J. Rearg. Br. 37) reflects its own inability to provide satisfactory answers and reinforces Allied-Signal's position here.

Even if the Court were not otherwise persuaded of the wrongheadedness of New Jersey's proposed "solution" to the problems of dividing the income of multistate businesses,[9] the mischievous practical consequences flowing from New Jersey's proposed regime militate against the abandonment of the existing constitutional structure. Two-thirds of the states' laws would be put in immediate constitutional jeopardy or, alternatively, there would be dramatic increases in multiple taxation. Allied-Signal Rearg. Br. 27-30. The problem of fair apportionment would be greatly exacerbated, as taxpayers and tax administrators struggled with the question of how to conform apportionment formulas to a radically expanded tax base. *Id.* at 25-27. And the potential for gross misattribution of income would increase dramatically, as would the lower courts' (and this Court's) entanglement with state tax apportionment. *Id.* at 31-33.

Against this background, it is all the more remarkable that New Jersey asks the Court to overrule *ASARCO* and

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[9] There is one additional error in New Jersey's brief that requires correction. New Jersey declares that "Bendix reported the ASARCO investment on the equity method . . . thereby indicating to the public that it had the ability to exercise significant influence over ASARCO." N. J. Rearg. Br. 45 n.32. This statement is simply wrong. Reporting on the equity method requires only that the shareholder own more than 20% of the corporation's stock; it is a purely mechanical test. Stip. ¶ 55 (J.A. 168). Moreover, the stipulated facts are that "Bendix did not exert any control over ASARCO." Stip. ¶ 54 (J.A. 168).

Woolworth without advancing any of the factors that traditionally have been understood to justify a departure from the principles of *stare decisis*. New Jersey fails even to suggest that *ASARCO* and *Woolworth* are inconsistent with other decisions of this Court. The State does not attempt to demonstrate that action by the Court is necessary " 'to bring its opinions into agreement with experience and with facts newly ascertained.' " *Vasquez*, 474 U.S. at 266 (citation omitted). And the disharmony in the lower courts asserted by New Jersey (a disharmony that, we show above, is in any event illusory (see p. 5 n.3)) would not be cured by New Jersey's proposed scheme; to the contrary, the State's approach would introduce an entirely new set of concededly intractable problems that would engender widespread confusion and extensive litigation. In these circumstances, New Jersey has not carried the "severe burden" imposed by the doctrine of *stare decisis* "on the litigant who asks [the Court] to disavow one of [its] precedents." *Thomas*, 448 U.S. at 272 (plurality opinion).[10]

V. IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE DECISION SHOULD NOT BE RETROACTIVE

There is one proposition that both parties and all of the *amici* that address the question accept: that the test of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), should determine whether a decision overruling *ASARCO* and *Woolworth* is retroactive. This unanimity on the part of taxpayers and taxing officials—even those whose short-term interests in this case might be furthered by a rule of absolute retroactivity—is a powerful reminder that

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[10] The list of Commerce Clause decisions that the Court has discarded in recent years, which are cited by New Jersey at Rearg. Br. 7 n.1, simply adds emphasis to the weakness of its argument in this case; all of those decisions were overruled in the wake of the Court's landmark holding in *Complete Auto*, which worked a dramatic change in the Court's analytical framework. There has, of course, been no such change in the unitary business principle since the decisions in *ASARCO* and *Woolworth*.

stability in the law is highly valued by all segments of society. While we agree with New Jersey on that point, however, the State unfortunately does not demonstrate the same good sense in its *application* of the three-part *Chevron Oil* test.

1. New Jersey (see N.J. Rearg. Br. 17-18) and several of its *amici* suggest that a decision overruling *ASARCO* and *Woolworth* would not "establish[] a new principle of law . . . by overruling clear past precedent" within the meaning of *Chevron Oil*'s first prong because the holdings in those decisions were undercut by the Court's subsequent ruling in *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159 (1983). That contention is wholly without substance. Citing *ASARCO* (among many other cases), the *Container* Court expressly *affirmed* the proposition that is dispositive here: "that the out-of-state activities of the purported 'unitary business' [must] be related in some concrete way to the in-state activities"—a connection that requires something beyond "the mere flow of funds arising out of a passive investment or a distinct business operation." *Id.* at 166.

At the same time, the *Container* Court's lengthy discussion of *ASARCO* and *Woolworth* did not retreat from the holdings of those decisions in any manner that is relevant here. To the contrary, the Court quoted extensively from *Woolworth* in observing that " '[s]ubstantial mutual interdependence' " between components of a business is necessary to support a finding of unitariness (463 U.S. at 179, quoting 458 U.S. at 371); "that a unitary business finding could not be based merely on 'the type of occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary' " (463 U.S. at 180 n.19, quoting 458 U.S. at 369); and that the parent in *Container* provided assistance and supervision to its subsidiaries that far exceeded any such connection in *ASARCO* and *Woolworth*. 463 U.S. at 179. Indeed, the

Court's opinion in *Container*, issued just a year after *ASARCO* and *Woolworth* were decided, was written by Justice Brennan and joined by Justices White and Marshall, all of whom also were in the majority in *ASARCO* and *Woolworth*. It is hardly likely that they intended *Container* to work a major departure from those holdings—or that taxpayers would have understood it to do so.[11]

2. New Jersey also asserts (N.J. Rearg. Br. 20) that retroactivity is mandated by the second prong of the *Chevron Oil* test because "[i]t would not further the new rule of law if New Jersey were to prevail but at the same time forfeit the revenue riding on the pending cases." But if that were a proper understanding of *Chevron Oil*, the second prong *always* would dictate retroactivity; under the State's approach, the purpose of the rule at issue necessarily is advanced by giving it effect into the past. In fact, the Court never has applied its test in such a circular fashion. Instead, as we explained in our opening brief on reargument (at 46), the Court has looked to whether retroactivity will help ensure compliance with its decisions and otherwise will advance particular federal policies. New Jersey has offered no reason to believe that to be the case here.

3. Finally, New Jersey contends (at N.J. Rearg. Br. 18-20) that the equities cut against retroactivity (and that there could not have been the reliance on past law that is an element of the first prong of the *Chevron Oil* test) because Bendix's acquisition and sale of ASARCO stock predated the decisions in *ASARCO* and *Woolworth*. This argument, of course, is premised on the assumption that *ASARCO* and *Woolworth* stated novel principles of law. But that is not so; we demonstrate above both that the

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[11] As we explain above (at p. 5 n.3), the state cases cited by New Jersey (at N.J. Rearg. Br. 17) as demonstrating confusion about the meaning of *ASARCO* and *Woolworth* did not, in fact, exhibit uncertainty on any point relevant here.

specific holdings of those cases had long before been anticipated in decisions like *Fargo* and *Wallace*, and that the Court *never* has embraced the "unity of ownership" theory that New Jersey advances here. Accordingly, the overruling of *ASARCO* and *Woolworth* on the grounds urged by New Jersey would involve a rejection of principles upon which taxpayers have relied for a century.

More generally, New Jersey simply urges the wrong inquiry when it looks to the circumstances of the particular litigants before the Court rather than the equities as they apply to *all* taxpayers and taxing authorities who would be affected by retroactivity. The State's narrower focus would have one of two consequences: either it would require that the retroactivity of a decision be settled as to everyone by the fortuitous balancing of the equities in the first case to reach the Court, or it would require the Court to apply different rules of law to different parties depending upon their particular circumstances. Neither of these approaches is palatable. The first is simply irrational. And the second, as Justice Souter recently explained, is inconsistent with basic notions regarding consistency in the rule of law:

> Nor . . . are litigants to be distinguished for choice-of-law purposes on the particular equities of their claims to prospectivity: whether they actually relied on the old rule and how they would suffer from retroactive application of the new. It is simply in the nature of precedent, as a necessary component of any system that aspires to fairness and equality, that the substantive law will not shift and spring on such a basis. . . . The applicability of rules of law are not to be switched on and off according to individual hardship; allowing relitigation of choice-of-law issues would only compound the challenge to the stabilizing purpose of precedent posed in the first instance by the very development of 'new' rules. Of course, the generalized enquiry permits litigants to assert, and the courts to consider, the equitable and

> reliance interests of parties absent but similarly situated.

James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439, 2447-2448 (1991) (opinion of Souter, J.).[12]

New Jersey makes no attempt to conduct such a generalized inquiry here. While it suggests (at N.J. Rearg. Br. 20 n.13) that taxpayers in UDITPA states might find some protection in existing state law limits on apportionment, the State simply disregards the effects of retroactivity on the many taxpayers in states like New Jersey, which have had statutes purporting to permit the taxation of intangible non-operational income; New Jersey would disrupt the expectations of such taxpayers so that the states could receive payments that "they had no reason to anticipate." *James Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting). And New Jersey wholly ignores the impact of its approach on the UDITPA states themselves, which would be opened to potentially devastating refund lia-

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[12] This appears to be the view of a majority of the Court. A plurality of the Court in *James Beam* was of the view that, "[o]nce retroactive application is chosen for any asssertedly new rule, it is chosen for all others who might seek its prospective application." 111 S. Ct. at 2447-2448 (opinion of Souter, J.). See *id.* at 2448-2449 (White, J., concurring in the judgment). As a consequence, Justice Souter proposed use of a generalized inquiry to avoid having retroactivity as to all determined by the peculiar circumstances of the first litigant. See *id.* at 2447 (opinion of Souter, J.) ("Because the rejection of modified prospectivity precludes retroactive application of a new rule to some litigants when it is not applied to others, the *Chevron Oil* test cannot determine the choice of law by relying on the equities of the particular case"). The *James Beam* dissenters, while reasoning that the retroactivity question should not be regarded as settled when the first case to apply the new rule did not use the *Chevron Oil* test (see *id.* at 2451-2452 (O'Connor, J., dissenting)), appeared to accept the proposition that *Chevron Oil*'s balancing of the equities requires a generalized inquiry. See *id.* at 2455 (O'Connor, J., disssenting) (emphasis added) (noting effect of retroactivity on "James Beam and *other liquor manufacturers*," and "on Georgia *and the other States* that reasonably relied on this Court's established precedent").

bility by a retroactive overruling of *ASARCO* and *Woolworth*. See Allied-Signal Rearg. Br. 29 n.13. In these circumstances, the equities—as well as the other elements of the *Chevron Oil* test—would mandate a holding of nonretroactivity.

CONCLUSION

For the foregoing reasons and the reasons expressed in our earlier briefs in this case, the judgment of the New Jersey Supreme Court should be reversed.

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APRIL 1992

Supreme Court, U.S.
FILED
APR 17 1992
OFFICE OF THE CLERK

No. 91-615

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL, INC.,
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The Supreme Court Of New Jersey

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES iii

ARGUMENT:

POINT I:

IN REQUIRING AN OPERATING RELATIONSHIP BETWEEN THE PAYOR AND PAYEE OF INTANGIBLES INCOME, *ASARCO* AND *WOOLWORTH* ARE INCONSISTENT WITH THE CONSTITUTIONAL CONSTRAINTS TRADITIONALLY IMPOSED ON THE STATES' TAXING POWER AND WITH EXISTING STATE TAX SCHEMES ... 1

A. *ASARCO* and *Woolworth* Do Not Follow Logically from the Court's Cases Interpreting the Due Process Clause 1

B. Property Tax Principles Cannot be Transplanted Wholesale To Cases Involving Net Income Taxes 3

C. Corporate Purpose, As Defined in *Container*, Would Be An Appropriate Test In The Single Entity Context But For The Impossibility of Drawing a Clear Line 4

POINT II:

NEW JERSEY'S PROPOSED RULE OF FULL APPORTIONMENT WITHIN SINGLE CORPORATE ENTITIES WOULD NOT DISRUPT OR RENDER UNCONSTITUTIONAL EXISTING STATE TAX SCHEMES 6

A. The Present Scheme Of Taxing Intangibles Income Is Not Uniform 7

TABLE OF CONTENTS – Continued

Page

B. The State of Commercial Domicile Has No Paramount Right To Tax Intangibles Income.. 9

C. Freeing the States To Apportion All Income of Nondomiciliary Corporations Would Not Render the UDITPA States' Tax Schemes Unconstitutional 11

D. Full Apportionment Would Not Necessarily Be Unfair 13

POINT III:

STARE DECISIS DOES NOT REQUIRE ADHERENCE TO *ASARCO* AND *WOOLWORTH* BECAUSE NEITHER SUBSTANTIVE PROPERTY LAW NOR CONTRACT RIGHTS ARE INVOLVED 16

POINT IV:

ASARCO AND *WOOLWORTH* SHOULD BE OVERRULED RETROACTIVELY BECAUSE LITIGANTS DID NOT LEGITIMATELY RELY ON THE TWO DECISIONS 18

CONCLUSION 20

APPENDIX

Charts Showing State Tax Deductions and Exclusions for Dividend Income..... 1a

Chart Showing State of Commercial Domicile of Corporations Filing *amici curiae* briefs..... 10a

TABLE OF AUTHORITIES

Page

Cases Cited

American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue, 143 Wis.2d 553, 422 N.W.2d 629 (Wis. App. 1988) 15

Arkansas Best Corp. v. Comm'r, 485 U.S. 212 (1988) 5

ASARCO Inc. v. Idaho State Tax Comm'n, 485 U.S. 307 (1982) ..... *passim*

Butler Bros. v. McColgan, 315 U.S. 501 (1942) 3, 4

Central Railroad Co. of Pennsylvania v. Pennsylvania, 370 U.S. 607 (1962) 11

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)..... 18

Container Corp. v. Franchise Tax Bd., 463 U.S. 159 (1983) ..... *passim*

Corn Products Refining Co. v. Comm'r, 350 U.S. 46 (1955) 5

F.W. Woolworth Co. v. Director, Div. of Taxation, 45 N.J. 466, 213 A.2d 1 (1965)..... 15

F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982) ..... *passim*

Fargo v. Hart, 193 U.S. 490 (1904) 4

Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939) 4

Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954)..... 2

Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425 (1980) 3, 9, 11

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) 6, 7, 11, 12

TABLE OF AUTHORITIES – Continued

Page

NCR Corp. v. Comptroller of the Treasury, 313 *Md.* 118, 544 *A.*2d 764 (1988) 15

NCR Corp. v. South Carolina Tax Comm'n, 304 S.C. 1, 402 *S.E.*2d 666 (1991) 15

Northwestern States Portland Cement Co. v. Minnesota, 358 *U.S.* 450 (1959) 2

Oregon ex rel. State Land Bd. v. Corvallis Sand & Gravel Co., 429 *U.S.* 363 (1977) 17

People ex rel. Alpha Portland Cement Co. v. Knapp, 230 *N.Y.* 48, 129 *N.E.* 202 (1920) 15

Standard Oil Co. v. Peck, 342 *U.S.* 382 (1952) 11

Tambrands Inc. v. State Tax Assessor, 595 *A.*2d 1039 (Me. 1991) 16

Trinova Corp. v. Michigan Dep't of Treasury, 111 *S.Ct.* 818 (1991) 16

United States v. Darusmont, 449 *U.S.* 292 (1981) 17

Welch v. Henry, 305 *U.S.* 134 (1938) 17

Wheeling Steel Corp. v. Fox, 298 *U.S.* 193 (1936) 3

Wisconsin v. J.C. Penney Co., 311 *U.S.* 435 (1940) 2, 9

STATUTES CITED

N.J. Stat. Ann. 54:10A-4(k)(5) (West 1986) 15

Uniform Division of Income For Tax Purposes Act, 7A *Uniform Laws Annotated* 355 (West 1985) 12

UDIPTA § 18 12

TABLE OF AUTHORITIES – Continued

Page

LAW CITED

1968 *Laws of New Jersey*, ch. 250..... 15

MISCELLANEOUS CITED

2 J.Bonbright, *Valuation of Property* (1937)..... 10

Dexter, "Taxation of Income from Intangibles of Multistate-Multinational Corporations," 29 *Vand. L. Rev.* 401 (1976)..... 8, 10, 15

Hellerstein, "State Taxation on Interstate Business: Perspectives of Two Centuries of Constitutional Adjudication," 41 *Tax Lawyer* 37 (1987)..... 12

J. Hellerstein, *State Taxation I Corporate Income and Franchise Taxes* (1983)..... 14

Keesling, "A Current Look At The Combined Report and Uniformity in Allocation Practices," 42 *J. of Taxation* 106 (Feb. 1975)..... 14

Keesling, "The Impact of the *Mobil* Case on Apportionment of Income," 1981 *B.Y.U.L. Rev.* 87..... 14

1 *Multistate Corporate Income Tax Guide* (CCH)..... 7

P. Hartman, *Federal Limitations on State and Local Taxation* (1981)..... 12

ARGUMENT

POINT I

IN REQUIRING AN OPERATING RELATIONSHIP BETWEEN THE PAYOR AND PAYEE OF INTANGIBLES INCOME, *ASARCO* AND *WOOLWORTH* ARE INCONSISTENT WITH THE CONSTITUTIONAL CONSTRAINTS TRADITIONALLY IMPOSED ON THE STATES' TAXING POWER AND WITH EXISTING STATE TAX SCHEMES.

A. *ASARCO* and *Woolworth* Do Not Follow Logically from the Court's Cases Interpreting the Due Process Clause.

Petitioner's discomfort with the holdings of *ASARCO Inc. v. Idaho State Tax Comm'n*, 485 *U.S.* 307 (1982) and *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 *U.S.* 354 (1982) is evident. It now maintains that the "essential holding" of the two cases is a rejection of the states' argument that the corporate purpose of an investment should determine its unitary character (Psb6)[1] and concedes that operating relationships between the payor and payee of investment income are not always necessary (Psb5 n.1).[2] Essentially, petitioner has abandoned its defense of the *ASARCO/Woolworth* payor-payee rule (*cf.* Pb15,23) and offers no response to New Jersey's argument that the payor-payee rule is not required by the Due Process Clause, is inconsistent with the Court's

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[1] The designation "Psb" refers to petitioner's supplemental brief on reargument.

[2] Petitioner, in fact, no longer disagrees with the proposition that the integration of an intangible with the taxpayer's unitary operations establishes that income from the intangible is apportionable (Psb11,18).

prior and subsequent decisions involving the unitary business principle, and has caused extensive litigation in the lower courts (Rsb12-14). This litigation results from the fact that the payor-payee rule cannot be squared with the definition in the Uniform Division of Income for Tax Purposes Act (UDITPA) of apportionable business income (*see* Rb 34) nor with the full apportionment states' statutory schemes permitting the inclusion of all income in the preapportionment tax base.[3] Moreover, the rule defies the common sense and experience of lower court judges and state tax administrators.

Petitioner asserts that *ASARCO* and *Woolworth's* rejection of the corporate purpose definition of a unitary investment derives from the fundamental requirement of the Due Process Clause that a state cannot tax activities lacking a minimum connection with the taxing state (Psb6). While that may be the rule of the Due Process Clause for state tax purposes, the Court's seminal cases construing the Clause do not hold that, once a taxpayer is doing business within a nondomiciliary taxing state, there must be a separate nexus with each and every out-of-state activity of the taxpayer in order for the state to include the income generated in part by that activity in the preapportionment tax base. *Miller Bros. Co. v. Maryland*, 347 *U.S.* 340, 344-45 (1954); *Wisconsin v. J.C. Penney Co.*, 311 *U.S.* 435, 444-45 (1940); *Northwestern States Portland Cement Co. v. Minnesota*, 358 *U.S.* 450, 460, 464-65

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[3] Petitioner (Psb5-6) and some of the *amici curiae* assume that the overruling of *ASARCO* and *Woolworth* would entail a complete jettisoning of the unitary business principle, but that is not necessarily the case. One alternative would be to abandon the payor-payee rule but retain the remaining elements of the unitary business principle, facing up to the fact that difficult, sometimes arbitrary, lines would have to be drawn.

(1959). The protections and benefits extended by a nondomiciliary state to the taxpayer justify imposition of an apportioned tax on the taxpayer's income. *Id.*

B. Property Tax Principles Cannot be Transplanted Wholesale To Cases Involving Net Income Taxes.

With the exception of *ASARCO* and *Woolworth*, the Court's unitary business cases involving corporate net income taxes have not required an "organic connection" between a nondomiciliary taxpayer's in-state and out-of-state activities (Rsb 30-33). The Court has found a sufficient connection by reason of the nature of a taxpayer's business, *see e.g. Mobil Oil Corp. v. Comm'r of Taxes*, 445 *U.S.* 425, 435 (1980), or the operational nature of an investment. *Container Corp. v. Franchise Tax Bd.*, 463 *U.S.* 159, 180 n.19 (1983). Mere "unity of ownership and management" may suffice. *Butler Bros. v. McColgan*, 315 *U.S.* 501, 508 (1942), and so may "largely unquantifiable transfers of value." *Container*, 463 *U.S.* at 164-65.

Petitioner's reliance on the early railroad property tax cases is misplaced because tangible property taxes involve the valuation of specific property located at a specific place on a specific day, while the attribution of net income involves an attempt to locate something that has no physical properties in and of itself, whose "location" can be determined only indirectly. *Wheeling Steel Corp. v. Fox*, 298 *U.S.* 193, 212 (1936). Thus, where the value of a corporation's stock was used to determine the value of its property within the taxing state, property such as bonds held outside the state and having no "organic connection" to the in-state property could not be

included in the total value which was to be apportioned by means of a mileage formula. *Fargo v. Hart*, 193 *U.S.* 490, 499, 501 (1904). Inclusion of the bonds in the tax base produced an apportioned value of more than $800,000, while the actual value of the corporation's tangible property within the taxing state amounted to less than $8,000. *Id.* at 497. On the other hand, where the state sought to impose a franchise tax measured by the value of a corporation's capital stock, the Court held that all the corporation's assets could be included despite the fact that the statutory formula allocated $23 million to the taxing state and the actual value of the corporation's in-state assets was approximately $3 million. *Ford Motor Co. v. Beauchamp*, 308 *U.S.* 331, 334 (1939).

Determining the source of a corporation's in-state net income is as elusive as determining the value of a state franchise. On a separate accounting basis, there may even be a loss within the taxing state, and yet, under the unitary business principle, income may be attributed to the state. *Butler Bros.*, 315 *U.S.* at 506-07. In short, the Court has consistently rejected in the net income tax context the kind of direct, operating link that petitioner seems to believe must be present in order to apportion income from intangibles. Petitioner's "organic connection" rule would reject the reasoning of the Court's unitary business cases involving net income taxes.

C. Corporate Purpose, As Defined in *Container*, Would Be An Appropriate Test In The Single Entity Context But For The Impossibility of Drawing a Clear Line.

Although petitioner maintains that *ASARCO* and *Woolworth* properly rejected a unitary business principle

founded on the purpose for which an investment is made, at the same time petitioner seems to adopt the corporate purpose doctrine described in *Container* (Psb18). In discussing Container's loans to its subsidiaries, the Court stated that the loans were made "to ensure that '[t]he overseas operations of [appellant] continued to grow and to become a more substantial part of the company's strength and profitability.' " *Container*, 463 *U.S.* at 180 n.19. Citing *Corn Products Refining Co. v. Comm'r*, 350 *U.S.* 46, 50-53 (1955), the Court suggested that "capital transactions can serve either an investment function or an operational function." *Id.* Thus, a business function or motive, which seems no different than a business purpose, can convert what would otherwise be a passive to an operational investment. Properly applied, this is the test we advocated in our initial brief (Rb18-19, 41-43), and we pointed out that Bendix' purchase of stock in ASARCO served three operational functions - further diversification of the company, generation of capital for one of Bendix' core businesses, and as a means of acquiring knowledge of ASARCO and the nonferrous metals business before enlarging or disposing of the investment. These purposes were no different, we pointed out, than Container's loans to its subsidiaries, which were made for the purpose of making the subsidiaries a more substantial part of the corporation (Rb42).

The difficulty of drawing a clear, predictable line between a capital transaction serving "an investment function" and one serving "an operational function," *Container*, 436 *U.S.* at 180 n.19, precisely the same difficulty that the Court confronted and resolved in *Arkansas Best Corp. v. Comm'r*, 485 *U.S.* 212 (1988), involving the *Corn Products* exception to the statutory definition of

capital asset (Rsb45), leads us to believe that a more workable, fair, and economically real place to draw the line is at the corporate entity.

POINT II

NEW JERSEY'S PROPOSED RULE OF FULL APPORTIONMENT WITHIN SINGLE CORPORATE ENTITIES WOULD NOT DISRUPT OR RENDER UNCONSTITUTIONAL EXISTING STATE TAX SCHEMES.

Petitioner suggests that the existing scheme for taxing multistate corporations is well settled and uniform (Psb14-21) and that any change would render the majority of the states' current tax schemes unconstitutional (Psb27) and would create intractable apportionment problems (Psb25, 31).

A brief reiteration of the rule we propose makes clear that many of petitioner's fears would not materialize. As to single corporate entities, the rule would permit a nondomiciliary state to include in the preapportionment tax base all the income of a multistate corporation doing business within that state. As all the income, not just income from intangibles, would be apportionable, none of the "form versus substance" problems suggested by petitioner (Psb23-24) would arise. The rule would simply permit a state to extend its taxing power to all the income of a nondomiciliary taxpayer doing business within it. The fact that the UDITPA states, by statute, allocate 100% of nonbusiness income to the commercial domicile would not render those statutes facially unconstitutional because the Court has held that the mere possibility of double taxation in a net income context is constitutionally acceptable. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 276-80

(1978). Thus, the constitutional havoc envisioned by petitioner (Psb27-30) would not materialize, nor would the "devastating liability for refunds" if the overruling of *ASARCO* and *Woolworth* were given retroactive effect (Psb47). We recognize that our proposed rule may increase the risk of multiple taxation of intangibles income and might require greater attention to the apportionment formula, but both of those problems exist currently, and should be dealt with in individual cases if and when they arise.

A. The Present Scheme of Taxing Intangibles Income Is Not Uniform.

Petitioner exaggerates in claiming that "the vast majority of states explicitly recognize the distinction between apportionable and allocable investment income . . . " (Psb16). In fact, 16 states, including New Jersey, apportion all or nearly all income from intangibles.[4] This would seem to be a rather substantial minority, whose taxing schemes are entitled to as much respect as the schemes of the majority that distinguish between business and nonbusiness income. *See Moorman* (sustaining Iowa's single-factor apportionment formula).[5]

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[4] The full apportionment states other than New Jersey include Connecticut, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New York, Ohio, Rhode Island, Texas, and Vermont. Minnesota, Nebraska, Virginia, and Wisconsin apportion nearly all income. *See* the appendix to this brief at Rrsa 6a-8a and 1 *Multistate Corporate Income Tax Guide* ¶167 (CCH).

[5] Only Nebraska and Texas, in addition to Iowa, use a single-factor apportionment formula. 1 *Multistate Corporate Income Tax Guide* ¶146 (CCH).

Petitioner's statement that the "prevailing pattern" ensures that there will be neither undertaxation nor overtaxation of investment income (Psb17) is not consistent with the impressions of state tax administrators that the present system results in substantial undertaxation of intangibles income. *See* the initial Brief *Amicus Curiae* of Multistate Tax Commission in Support of Respondent at 23 n.8; *ASARCO*, 458 *U.S.* at 345 (O'Connor, J., dissenting); Dexter, "Taxation of Income from Intangibles of Multistate-Multinational Corporations," 29 *Vand. L. Rev.* 401, 403 (1976). This is a case in point since Michigan apportioned Bendix' gain on the ASARCO stock sale, and under the *ASARCO/Woolworth* payor-payee rule, no other state would tax the income.[6]

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[6] Included in the appendix to this brief is a chart showing the state of commercial domicile of each of the corporations that have joined in an *amicus* brief at this stage of the proceedings (Rrsa 9a-10a). Of the 32 corporations, 20 have their corporate domiciles in states that apportion, or largely apportion, investment incomes; 10 of the remaining 12 are headquartered in states that, while allocating investment income to the commercial domicile, exclude or largely exclude dividend income, and of the remaining two, Chevron Corporation, headquartered in California, has filed an *amicus* brief in support of New Jersey urging presumptive full apportionment of intangibles income. *See* Rrsa 1a-8a showing the full apportionment states, the UDITPA states, and the exclusions for dividend income. One has to wonder about multistate corporations' claims of excessive state taxation of investment income (Pb42; Psb30) unless there is a constitutional right, of which we are unaware, to pay tax on less than 100% of investment income. *Cf.* Brief of *Amici Curiae* in support of Petitioner by American Home Products Corporation *et al.* at 2, expressing the concern that "all of [*amici*'s] intangible income would be apportionable by nondomiciliary States."

Under the internal consistency test, an apportionment formula, if applied by all the states, cannot result in more than 100% of a corporation's income being subjected to tax. *Container*, 463 *U.S.* at 169. The "prevailing pattern," particularly if the *ASARCO/Woolworth* payor-payee rule is strictly applied, results in far less than 100% of a corporation's income being subjected to tax because large amounts of intangibles income are removed from the base before the apportionment formula is applied. The "prevailing pattern" is not workable (Rsb12), is certainly not equitable to the states, is not "substantially uniform," and above all, has no relation to economic reality (Rsb11,42), a point that petitioner does not address.

B. The State of Commercial Domicile Has No Paramount Right To Tax Intangibles Income.

Petitioner's argument that the commercial domicile somehow offers benefits and protections justifying taxation of 100% of so-called nonbusiness income was rejected in *Mobil*, 445 *U.S.* at 445-46. New Jersey offered substantial protections and benefits to Bendix' aerospace and industrial energy divisions, protections and benefits which made it possible for Bendix to earn 8% of its net income in the State. The protections and benefits extended by New Jersey entitle it to "ask return" commensurate with the business conducted there, *J.C. Penney Co.*, 311 *U.S.* at 444-45, and the ASARCO investment was part of that business.[7]

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[7] It is not true that Bendix managed its investments exclusively at its commercial domicile in Michigan (cf.

(Continued on following page)

At bottom, petitioner's theory that the state of commercial domicile has a paramount right to tax income from intangibles rests on the misconception that corporate investing is somehow segregated from corporate operations. As we made clear in our initial brief, the record in this case belies the notion because it establishes that Bendix had a corporate function of investing in other corporations as a means of diversification and growth. The Bendix CEO viewed the corporation as consisting of pools of assets, including both operating assets and investment assets (J.A. 137). As we indicated in our supplemental brief, Bendix' mixing of investment and operational strategies is not unique. The line between operations and investments is fuzzy from an accounting standpoint, and corporate investing is on a continuum (Rsb42-43). Petitioner may be right that 55 years ago, in the context of property tax valuation methods, there was such a thing as "assets of an interstate corporation [that] are . . . completely divorced from the interstate business . . . ," but that does not appear to be true today. *Cf.* 2 J. Bonbright, *Valuation of Property*, 660 (1937) (quoted at Psb13),[8] but *see* Dexter, *supra* at 413, 418. As petitioner

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Psb20 n.10). The Lehman Brothers account into which the proceeds of Bendix' various stock sales were placed was presumably managed in New York City where Lehman Brothers was located (J.A. 181 ¶117).

[8] Professor Bonbright goes on to recognize that there is no sharp line between assets that contribute to the whole system and those that do not, Bonbright, *supra* at 661, and concludes that, since the question is one of degree and gradations that "are not sharply defined, practical expediency requires frankly arbitrary rules rather than theoretically satisfying solutions." *Id.*

itself has recognized, the 1980's witnessed "a significant increase in the scope and size of corporate diversification" (Pb41-42).

C. Freeing the States To Apportion All Income of Nondomiciliary Corporations Would Not Render the UDITPA States' Tax Schemes Unconstitutional.

Petitioner suggests (Psb27) that a rule permitting the states to apportion all intangibles income would render unconstitutional the laws of a majority of the states that distinguish between business and nonbusiness income because the income would be doubly taxed, once in full at the corporate domicile and again on an apportioned basis in a full apportionment state. But in the context of a corporate net income tax, the risk of double taxation, *Moorman*, 437 *U.S.* at 278-79, or even actual double taxation, *Container*, 463 *U.S.* at 187-88 and n.22, does not necessarily render either state's tax unconstitutional. Although, "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate," *Mobil*, 445 *U.S.* at 444, the rule to date appears to apply only to *movable* tangible property such as boats and barges, *Standard Oil Co. v. Peck*, 342 *U.S.* 382 (1952), and freight cars. *Central Railroad Co. of Pennsylvania v. Pennsylvania*, 370 *U.S.* 607 (1962). In the context of a net income tax, *Moorman* and *Container* suggest that theoretical claims of double taxation, with no factual showing of an "existing duplicative tax," *Mobil*, 445 *U.S.* at 444, cannot succeed.

As made clear in the appendix to our supplemental brief (Rsa21a-23a), allegations of double taxation of intangibles income to date have been relatively infrequent even though the potential for double taxation inheres in

the present system. *Moorman*, 437 *U.S.* at 279. As indicated in the appendix to this brief (Rrsa1a-5a), of the 28 states that allocate 100% of nonbusiness income to the commercial domicile, 16 exclude 70% or more of dividend income from the tax base, thereby substantially reducing the risk of double taxation, and 11 of the 16 states that apportion all or nearly all intangibles income exclude at least 50% of dividend income from the tax base, thereby further reducing the risk of double taxation. See *supra* n. 6. Moreover, a UDITPA state, faced with a claim of double taxation by a domiciliary taxpayer, might well offer a credit or some other adjustment under UDITPA's discretionary relief provision. 7A *Uniform Laws Annotated* 355 (West 1985), *UDIPTA* § 18. Thus, double taxation is not the inevitable result of full apportionment. *Container*, 463 *U.S.* at 188, 192-93.

In sum, the Constitution, through the Due Process and Commerce Clauses, merely limits a state's taxing power. P. Hartman, *Federal Limitations on State and Local Taxation*, 12, 14, 17-19, 21 (1981); Hellerstein, "State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication," 41 *Tax Lawyer* 37, 40, 50, 74 (1987). The Constitution does not *require* the states to extend their taxing power, does not mandate a single, uniform apportionment rule, *Moorman*, 437 *U.S.* at 279, and does not, in the context of a state corporate net income tax, condemn a taxing scheme that may produce, or even does produce, instances of double taxation. *Container*, 463 *U.S.* at 187-93.[9] Whether our proposed rule

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[9] Petitioner's notion that a rule permitting some states to fully apportion intangibles income while others taxed it in full

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would result in actual double taxation should abide a record demonstrating that fact. Here, due to the fact that Michigan apportioned the ASARCO gain, there is no evidence whatever of double taxation.

D. Full Apportionment Would Not Necessarily Be Unfair.

Petitioner asserts that the apportionment of all intangibles income would violate the external consistency test (Psb25) and, if extended to the apportionment of both operating and intangibles income, would lead to gross misattributions of income (Psb31-33). Petitioner's argument on both scores is grounded in its belief that intangibles income and operating income earned within a single corporate entity may indeed be unrelated to the unitary business being conducted in the taxing state.[10] The record in this case, modern business' approach to corporate investing (Rsb42-43),[11] the inability of the accounting profession to pigeonhole investing and operating activities (Rsb43-44), and the potential for manipulation inherent in

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at the commercial domicile would produce a tax of 200% on investment income would materialize only if the state of the corporation's domicile were the only remaining state to distinguish between business and nonbusiness income, while every other state had adopted full apportionment. Moreover, the figure assumes that no state would exclude the intangibles income and that the state of commercial domicile would refuse any relief in the face of clear evidence of multiple taxation.

[10] Petitioner's appendix reflects the same conceptual flaw: Depending upon the facts, a UDITPA state may treat intangibles income as apportionable business income.

[11] The designation "Rsb" refers to respondent's supplemental brief on reargument.

a constitutional rule under which large amounts of income are in or out of the tax base depending upon considerations of business motive (Rsb44-45) strongly suggest that there are no economically real distinctions between various corporate activities and that, if distinctions are to be made, they are essentially arbitrary. Bonbright, *supra*, at 661. Scholarly commentary agrees. Frank Keesling, one of the "distinguished students" cited by petitioner as authority for the proposition that investment income should not be included in the apportionable tax base (Psb13), subsequently came to the opposite conclusion, suggesting that it might be preferable to apportion income from securities purchased to promote a corporation's business. Keesling, "The Impact of the *Mobil* Case on Apportionment of Income," 1981 *B.Y.U.L. Rev.* 87, 99. In an earlier article, Mr. Keesling questioned "whether there is such a thing as a non-unitary business," stating:

> Wherever there is common ownership there is a certain amount of common management, centralized performance of certain functions, and other indications of integration. [Keesling, "A Current Look At The Combined Report and Uniformity in Allocation Practices," 42 *J. of Taxation* 106, 109 (Feb. 1975)].

To the extent that intangibles constitute part of a unitary business, the standard three-factor apportionment formula may be viewed as properly assigning the income of a multistate corporate taxpayer among the jurisdictions where it does business. J. Hellerstein, *State Taxation I Corporate Income and Franchise Taxes*, 559 (1983). If the unitary business is deemed to be congruent with the corporate entity, the three-factor formula, without

adjustment, may continue to provide a fair apportionment (Rsb37). *See* Dexter, *supra* at 407, 411-12, 418, 420.

On the other hand, if inclusion of intangibles income in the preapportionment tax base and application of the standard three-factor formula does in fact attribute too much intangibles income to a particular state, state courts are quite able to deal with the problem. For example, in *F.W. Woolworth Co. v. Director, Div. of Taxation*, 45 *N.J.* 466, 499, 213 *A.*2d 1, 19 (1965), the New Jersey Supreme Court remanded the case for consideration of factor relief after concluding that the dividends from Woolworth's foreign subsidiaries were unitary income.[12] Since the lower

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[12] Subsequent to New Jersey's *Woolworth* case, the New Jersey Legislature enacted the 100% dividend exclusion for dividends from subsidiaries owned to the extent of 80% or more. 1968 *Laws of New Jersey*, ch. 250; *N.J. Stat. Ann.* 54:10A-4(k)(5) (West 1986).

Other cases in which state courts have provided for factor relief after including intangibles income in the preapportionment tax base include *People ex rel. Alpha Portland Cement Co. v. Knapp*, 230 *N.Y.* 48, 129 *N.E.* 202 (1920) (invalidating statutory provisions that included investment income without including investment values in formula); *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 143 *Wis.*2d 553, 422 *N.W.*2d 629, 636-37 (Wis. App. 1988) (invalidating apportionment formula under external consistency test where public utility had $500 million in operating income and nearly $3 billion in dividend income from subsidiaries, and remanding to revenue department to determine a fair apportionment); *NCR Corp. v. Comptroller of the Treasury*, 313 *Md.* 118, 154, 544 *A.*2d 764, 781 (1988) (remanding to state tax court to adjust apportionment formula where dividends from foreign subsidiaries were included in preapportionment tax base); *NCR Corp. v. South Carolina Tax Comm'n*, 304 S.C. 1, 402 *S.E.*2d 666, 673-74 (1991) (remanding to lower court to adjust apportionment formula where income from

(Continued on following page)

courts are fully capable of dealing with fair apportionment issues, there is no need for the Court to prohibit full apportionment of income within a single corporate entity on the ground that the external consistency test would be routinely violated.

Nor can it be convincingly maintained that full apportionment of all income earned by separate corporations results in gross misattributions of income (Psb 31-33). Again, the justification for full apportionment is the impossibility of segregating distinct corporate activities that are linked by common ownership and common management. Where these factors exist, i.e. within a single corporation, apportioning the income among the states continues to "bear[] some resemblance . . . to slicing a shadow." *Container*, 463 *U.S.* at 192. Thus, the "practical [and] theoretical justification" for apportionment, *Trinova Corp. v. Michigan Dep't of Treasury*, 111 *S.Ct.* 818, 829 (1991), continues to exist and in fact militates in favor of full apportionment of all income within a single corporation (*cf.* Psb32).

POINT III

STARE DECISIS DOES NOT REQUIRE ADHERENCE TO *ASARCO* AND *WOOLWORTH* BECAUSE NEITHER SUBSTANTIVE PROPERTY LAW NOR CONTRACT RIGHTS ARE INVOLVED.

As we demonstrated in our initial brief, considerations of *stare decisis* should not impede the overruling of

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foreign subsidiaries was included in preapportionment tax base); *Tambrands Inc. v. State Tax Assessor*, 595 *A.*2d 1039, 1045 (Me. 1991)(remanding to taxing authority to "include additional factors in the apportionment formula" because dividends from foreign affiliates that were taxed by foreign countries were included in the preapportionment tax base).

ASARCO and *Woolworth* because the cases were badly reasoned, have proved to be inconsistent with economic reality, and have produced incoherent, inconsistent results in the lower courts.

Petitioner maintains that the two cases should stand because the rules at issue "involve property interests" where it is necessary for people to be able to predict the legal consequences of their actions (Psb36). But *ASARCO* and *Woolworth* do not involve simply property interests, and they certainly do not involve "substantive property law as such . . . " *Oregon ex rel. State Land Bd. v. Corvallis Sand & Gravel Co.*, 429 *U.S.* 363, 381 (1977). Rather, the issue relates to business taxpayers' expectations in the face of the states' taxing power. "In cases such as this, considerations of *stare decisis* play a less important role than they do in cases involving substantive property law." *Id.*

Moreover, to the extent that *ASARCO* and *Woolworth* are out of sync with the Court's preceding and subsequent unitary business cases, a return to the proper rule should conform more closely to business taxpayers' reasonable expectations. *Id.* at 382. Taxpayers plainly have no contract or property rights in a specific level of taxation. *Welch v. Henry*, 305 *U.S.* 134, 146 (1938). If it were otherwise, Congress could not enact tax statutes that apply to periods prior to enactment, which it has done repeatedly. *United States v. Darusmont*, 449 *U.S.* 292, 296, (1981). Nor can petitioner reasonably claim that it or any other business taxpayer legitimately relied on the *ASARCO/Woolworth* payor-payee rule when the rulings

provoked repeated litigation in the lower courts (Rsa21a-25a).[13]

POINT IV

ASARCO AND *WOOLWORTH* SHOULD BE OVERRULED RETROACTIVELY BECAUSE LITIGANTS DID NOT LEGITIMATELY RELY ON THE TWO DECISIONS.

In arguing that *ASARCO* and *Woolworth* should be overruled prospectively under *Chevron Oil Co. v. Huson*, 404 *U.S.* 97 (1971), petitioner virtually assumes that an overruling decision would "establish a new principle of law . . . by overruling clear past precedent on which litigants may have relied. . . . " *Id.* at 106-07. But as we pointed out in our supplemental brief, Bendix could not possibly have relied on *ASARCO* and *Woolworth* when it decided to sell the ASARCO stock because the decision to sell was made before *ASARCO* and *Woolworth* were handed down (Rsb18). Nor is it accurate to say that *Container* did not cast doubt on the continuing vitality of the two decisions. *See id.* at n. 7. The Court's brief reference to *ASARCO* in *Trinova*, 111 *S.Ct.* 834, for the proposition that Michigan's single business tax did not tax " 'value earned outside [Michigan's] borders' " hardly amounts to a reaffirmation of the *ASARCO/Woolworth* payor-payee rule.

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[13] Petitioner now advises that virtually all the lower courts followed *ASARCO* and *Woolworth* (Psb38), but in its petition for *certiorari* petitioner pointed to the conflicting decisions in the lower courts (Pet. at 13) and claimed that "many state court decisions . . . reflect both uncertainty and confusion regarding the [applicable] constitutional constraints . . . ." (Pet. at 16).

As to whether retroactive application will further a rule extending the states' taxing power, at least to the extent that states have assessed and denied refunds in the belief that *ASARCO* and *Woolworth* did not preclude them from taxing an apportioned share of intangibles income, retroactive application would seem to further the new rule. Otherwise, as we stated previously, while prevailing on the legal principle, the states could be exposed to substantial refund claims and could lose the assessment cases currently pending (Rsb19-20).

Contrary to petitioner's claim (Psb47), the equities do not favor prospective overruling. Nine of the 16 full apportionment states exclude between 70% and 100% of dividend income and two others (New York and New Jersey) exclude between 50% and 100% of dividend income (Rrsa6a-8a). Thus, as to the major category of recurring intangibles income, most of the full apportionment states would not be making retroactive assesssments if *ASARCO* and *Woolworth* were overruled retroactively. Moreover, as made clear in the appendix to our supplemental brief (Rsa21a-25a), the includability of capital gains and interest income has been actively litigated in the full apportionment states. *See* also Brief for *Amici Curiae* Massachusetts *et al.* Supporting Respondent at 4. Thus, multistate taxpayers in those states cannot claim surprise that their intangibles income would continue to be assessed by those states. As to refunds owing to domiciliary taxpayers in states that allocate 100% of nonbusiness income to the commercial domicile, more than half of these states already exclude between 70% and 100% of dividend income (Rrsa1a-5a). Further, as we have said previously, our proposed rule would not render the UDITPA states' statutes automatically unconstitutional

and thus these allocating states would not be exposed to massive refund claims.

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of New Jersey should be affirmed, *ASARCO* and *Woolworth* should be overruled retroactively, and the states should be permitted to apportion all the income of nondomiciliary corporations doing business within their borders.

Respectfully submitted,

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April 1992

Dividend Income Deducted or Excluded from Corporate Income Taxation in States That Distinguish Between Business and Non-Business Income*

State	Special fed. deduction adopted?**	Any State Dividend Exclusion?
AL	No	Exclusion for dividends from 50% subsidiaries. Ala. Code § 40-18-35(a)(14).
AK	Yes, 70-100% excluded.	No
AZ	No	Exclusion for dividends from Az. taxed payor; from controlled payor if commercial domicile in Az. or, if commercial domicile outside Az. 50% in 1990 and 100% thereafter. Ariz. Rev. Stat. Ann. § 43-1122 and § 43-1128.

* Sources: *Multistate Corporate Income Tax Guide* ¶ 79 (CCH); state statutes cited herein.

** Pursuant to IRC § 243, a corporation may deduct from its taxable income 100% of qualifying dividends received from a member of its affiliated group, 100% of dividends received by a small business investing company, and 70% of all other dividends. The Code also provides for deductions of dividends received on certain preferred stock, IRC § 244, and from certain foreign corporations, IRC § 245. Where a "Yes" is included in this column, the State has adopted these federal deductions and, thus, excludes 70-100% of all dividends from taxable income.

State	Special fed. deduction adopted?	Any State Dividend Exclusion?
AR	No	Exclusion for dividends from 95% subsid. and on stock of capital development corporations. Ark. Code Ann. § 26-51-404(b)(9) and § 15-4-1025.
CA	No	Amount of exclusion depends on degree of affiliation with payor B for dividends from Cal.-taxed payor; exclusion for intercompany dividends in combined report, and for dividends from certain foreign construction projects. Cal. Rev. and Tax. Code § 24402, § 24411 and § 25106.
CO	Yes, 70-100% excluded.	No
FL	Yes, 70-100% excluded.	No
HI	No	Partial or total exclusion for dividends from controlled payor. Haw. Rev. Stat. § 235-7(c).

State	Special fed. deduction adopted?	Any State Dividend Exclusion?
ID	No	Partial exclusion for dividends from Idaho-taxed payor; special provisions under water's edge election. Idaho Code § 63-3022(e) and (f).
IL	Yes, 70-100% excluded.	Plus foreign dividends excluded. Ill. Income Tax Act § 203(b)(2).
IN	Yes, 70-100% excluded.	Plus partial or total exclusion of foreign dividends. Ind. Code Ann. § 6-3-2-12.
IA	Yes, 70-100% excluded.	No
KS	Yes, 70-100% excluded.	Plus 80% exclusion of post-1987 foreign dividends. Kan. Stat. Ann. § 79-32,138.
KY	No	All dividends excluded. Ky. Rev. Stat. Ann. § 141.010(12)(b).
MS	No	All dividends taxed except from issuers taxed by Mississippi and certain dividends from investment trusts. Miss. Code Ann. § 27-7-15(1) and (4).

State	Special fed. deduction adopted?	Any State Dividend Exclusion?
MO	Yes, 70-100% excluded.	Plus exclusion of all corporate dividends from sources w/in Missouri. Mo. Ann. Stat. § 143.431.
MT	Yes,* 70-100% excluded.	Plus 80% exclusion of all apportionable dividends and water's edge election. Mont. Code Ann. § 15-31-325.
NM	Yes, 70-100% excluded.	No
NC	No	Exclusion dependent upon percentage of business done in N.C. by payor. N.C. Gen. Stat. § 105-130.7; See, *Multistate Corporate Income Tax Guide*, ¶ 3708.21 (CCH).
ND	No	Exclusion for dividends from N.D. N.D. Cent. Code § 57-38-01.3(1)(g).
OK	Yes, 70-100% excluded.	No
OR	No	Exclusion for 70% of all dividends except for certain specific types; 80% deductible if from 20% owned payor. Or. Rev. Stat. § 317.267.

* In *Baker Bancorporation, Inc. v. Dept. of Rev.*, 657 P.2d 89 (1982), the Montana Supreme Court ruled that the federal dividend deductions are allowed, since they are not expressly disallowed by Montana's tax law.

State	Special fed. deduction adopted?	Any State Dividend Exclusion?
PA	No	Exclusion for all dividends. Pa. Stat. Ann. Tit. 72, § 7401(3)1(a) and (b).
SC	Yes, 70-100% excluded.	But, foreign dividend gross-up not deductible. S.C. Code Ann. § 12-7-430.
SD	No	Exclusion for dividends received from financial institutions subject to S.D. franchise tax. S.D. Codified Laws Ann. § 10-43-10.2(7) and § 10-43-10.3(2).
TN	No	Exclusion for dividends from 80% owned subsidiary only. Tenn. Code Ann. § 67-4-805(b)(2)(A).
UT	No	100% exclusion of dividends from non-unitary subsidiaries plus water's edge election. Utah Code Ann. § 59-7-106(2)(d).
WV	Yes, 70-100% excluded.	No

Dividend Income Deducted or Excluded from Corporate Income Taxation in States That Apportion All or Nearly All Income*

STATE	DIVIDEND DEDUCTION OR EXCLUSION
CT	100% exclusion of all dividends, except that no exclusion is allowed for 30% of dividends from domestic corporation in which taxpayer owns less than 20%. Conn. Gen. Stat. Ann. § 12-217.
ME	Federal dividend deduction** plus phased in subtraction ('89-'93) for apportionable dividends from affiliates not included in combined report. Me. Rev. Stat. Ann. tit. 36 § 5200-A.2(G).
MD	Federal dividend deduction plus subtraction for dividends from controlled foreign corp. and from DISCs. Md. Code Ann., Tax-Gen. § 10-307.
MA	Dividends 95% deductible except for dividends from (1) less than 15% owned corp., (2) Mass. Corp. trust, and (3) non-wholly owned DISCs. Mass. Gen. Laws Ann. ch. 63, § 38(a).
MI	Exclusion for all dividends. Mich. Comp. Laws Ann. § 208.9(7)(a).

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* Sources: *Multistate Corporate Income Tax Guide* ¶ 79 (CCH); state statutes cited herein.

** Pursuant to IRC § 243, a corporation may deduct from its taxable income 100% of qualifying dividends received from a member of its affiliated group, 100% of dividends received by a small business investing company, and 70% of all other dividends. The Code also provides for deductions of dividends received on certain preferred stock, IRC § 244, and from certain foreign corporations, IRC § 245. The States which have adopted these federal deductions thus exclude 70-100% of all dividends from taxable income.

STATE	DIVIDEND DEDUCTION OR EXCLUSION
MN	80% deductible if from 20% owned payor and stock from which paid meets certain conditions; 70% deductible if from less than 20% owned payor; remaining "excess qualifying dividends" if from insurance or investment company that is member of same affiliated group and dividends are eliminated in federal consolidation. Minn. Stat. Ann. § 290.21.4.
NE	Federal dividend deduction plus exclusions of dividends from foreign corporations. Neb. Rev. Stat. § 77-2734.04(6) and § 77-2734.08.
NH	Exclusion for (1) dividends received by parent if subsidiary subject to tax or not unitary, (2) deemed DISC subject to tax, and (3) dividends from foreign affiliates; special provisions under water's edge election. N.H. Rev. Stat. Ann. § 77-A:4.
NJ	50% exclusion generally; 100% of dividends from 80% owned subsidiaries. N.J. Stat. Ann. § 54:10A-4(k)(5).
NY	100% deductible if from more than 50% owned subsidiary; 50% deductible otherwise. N.Y. Tax Laws § 208.9.
OH	Federal dividend deduction plus exclusion of all dividends where payor at least 25% owned by payee, and all dividends of foreign subsidiaries and affiliates. Ohio Rev. Code Ann. § 5733.04(I) and § 5733.042(A)(6).

STATE	DIVIDEND DEDUCTION OR EXCLUSION
RI	Federal dividend deduction plus exclusion for dividends on income taxed by R.I. R.I. Gen. Laws § 44-11-11 and § 44-11-12.
TX*	All dividends included in net taxable earned surplus, except dividends from certain foreign subsidiaries and affiliates. Tex. Code Ann. § 171.110.
VT	Federal dividend deduction. Vt. Stat. Ann. tit. 32 § 5811(18).
VA	Federal dividend deduction plus exclusion for dividends from 50% owned subsidiaries to the extent included federally. Va. Code Ann. § 58.1-402(C)(10).
WI	Exclusion for dividends from certain Wis.-taxed payors, and from 80% owned subsidiaries; "dividends received" excludes foreign taxes deducted federally. Wis. Stat. Ann. § 71.26(3)(j).

* Effective January 1, 1992, Texas enacted a tax on the "net taxable earned surplus" of corporations. Tex. Code Ann. § 171.002 *et seq.*

AMICI CURIAE CORPORATIONS	COMMERCIAL DOMICILE*
American General Corp.	Texas
American Home Products Corp.	New York City
Amway Corp.	Michigan
ASARCO Inc.	New York City
Asea Brown Boveri, Inc.	Connecticut
Ashland Oil Inc.	Kentucky
Avon Products, Inc.	New York City
Beatrice Co.	Illinois
Borden Inc.	New York City
Chevron Corp.	California
Coca-Cola Co.	Georgia
Colgate-Palmolive Corp.	New York City
Ford Motor Co.	Michigan
General Mills, Inc.	Minnesota
Georgia-Pacific Corp.	Georgia
Household International, Inc.	Illinois
ICI Americas Inc.	Delaware
International Business Machines Corp.	New York State
International Paper Co.	New York State
James River Corp. of Virginia	Virginia
Limited Stores Inc.	Ohio
Loews Corp.	New York City
Mead Corp.	Ohio
Mobil Oil Corp.	Virginia
NCR Corp.	Ohio
Phillips Petroleum Co.	Oklahoma
Premark International, Inc.	Illinois

AMICI CURIAE CORPORATIONS	COMMERCIAL DOMICILE*
RJR Nabisco Holdings Corp.	New York City
Safeway Inc.	California
Scott Paper Co.	Pennsylvania
Square D Co.	Illinois
W.R. Grace & Co.	New York City

* Sources: *Standard & Poor's Register of Corporations, Directors and Executives,* Vol. I (1992); *America's Corporate Families,* Vol. I (Dun's Marketing Services 1991).

EDITOR'S NOTE

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CASE NUMBER: 91-795

THE SUPREME COURT OF THE UNITED STATES

April 1992

ALLIED-SIGNAL, INC. V.
DIR., DIVISION OF TAXATION

On Writ of Certiorari from
the Supreme Court of New Jersey

BRIEF OF AMICUS CURIAE GEORGIA COALITION OF MILITARY/ FEDERAL RETIREES, INC.

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TABLE OF CONTENTS

Table of Authorities ii

Interest of Amicus Curiae iii

Question Presented v

Argument Summary v

Argument 1

Exhibit A 9

Exhibit B 12

TABLE OF AUTHORITIES

American Trucking Associations, Inc. v. Smith, ___ U.S. ___, 110 S.Ct. 2323 (1990) 1, 4, 6

Chevron Oil v. Huson, 404 U.S. 97, 92 S.Ct. 349 (1971) 1

McKesson Corp. v. Florida Alcohol & Tobacco Div., 496 U.S. 18, 110 S.Ct. 2238 (1990) 7

Waldron v. Collins, 758 F.2d 736 (11th Cir. 1986) 3

28 U.S.C. § 1341 2

104 Harvard L.Rev. 1731 (1990) 4

INTEREST OF AMICUS CURIAE

The Georgia Coalition of Military/Federal Retirees, Inc. is a statewide organization in Georgia that represents military and civil service retirees of the United States. The Coalition has sponsored three lawsuits in Georgia, encompassing 2700 retirees, seeking refunds from the State of Georgia for illegally collected taxes under the authority of Davis v. Michigan Dept. of Treasury, 489 U.S. 803, 109 S.Ct. 1500 (1989). To this point, Georgia has rejected refunds on the basis that Davis does not apply retroactively under the analysis employed in Chevron Oil v. Huson, 404 U.S. 97, 92 S.Ct. 349 (1971). Reich v. Collins, Clayton County Superior Court, Civil Action No. 90CV-18383-4, Order of December 11, 1991. Oral argument in the

Reich case is scheduled in the Georgia Supreme Court on Tuesday, April 14. Whatever decision is issued by the Georgia Supreme Court, a Petition for Certiorari to this Court will be filed.

The issue of retroactivity raised in Part 2 of this Court's Order of March 11, 1992 is at the heart of the dispute between the parties in the Georgia case.

QUESTION PRESENTED

Should retroactive relief be denied the taxpayer in the event this Court overrules Asarco v. Idaho State Tax Commissioner, 458 U.S. 307 (1982) and F.W. Woolworth Co. v. Taxation and Revenue Department, 458 U.S. 354 (1982).

ARGUMENT SUMMARY

Retroactive relief should be denied, but the Court should reformulate the test for prospective only relief by characterizing the test as one of remedies and limiting the test to cases that clearly break with established authorities.

ARGUMENT AND CITATION OF AUTHORITY

This Court Should Adopt a Rule of Retroactivity that is Based on the Law of Remedies and Limited to Cases that Break with Clearly Established Precedence.

The rule of retroactivity of Chevron Oil v. Huson, 404 U.S. 97, 92 S.Ct. 349 (1971), as applied in American Trucking Associations, Inc. v. Smith, ___ U.S. ___, 110 S.Ct. 2323 (1990) does not work. It absolutely abrogates the obligation of the states to protect the constitutional rights of its citizens in taxing matters. The practical effect of Chevron is that, in tax refund cases, state courts have denied retroactive relief by the score of 31-6. (Exhibits A and B). Of the cases where refunds have been granted, half of those involve local governments. (Exhibit B).

Thus, the impact of Chevron to the states is that the states need not be concerned about the constitutionality of

taxing provisions. If a taxing provision is found unconstitutional, it will invariably be applied prospectively only.

The Coalition respectfully submits that this is exactly the opposite from what the incentive for states should be. States should be compelled to scrupulously protect the constitutional rights of their citizens, especially in the critical area of taxing. Special interests create powerful political incentives for discriminatory taxing. Additionally, for a lone taxpayer, the discriminatory tax may be too small to merit the time and expense of litigation. Indeed, in Davis, it took a pro se plaintiff to finally challenge a widespread practice that was clearly illegal.

This problem is compounded by the Tax Injunction Act (28 U.S.C. § 1341) which bars taxpayers from federal court if

procedural avenues are available in state courts. This problem is also aggravated by state laws that do not permit class actions against the state. See, Waldron v. Collins, 758 F.2d 736 (11th Cir. 1986).

In areas where a state is uncertain about the constitutionality of a particular tax, the state should be strongly discouraged from implementing the tax. If the law is indeed unclear, the state has the opportunity to obtain declaratory relief or obtain a determination via a test case. The state can also seek revenues in the expansively broad area of established, constitutionally permitted taxation.

The Coalition concedes that there may be abrupt shifts in the law and that there are certain reliance interests of the State. The Coalition proposes a two part test that will balance these competing

interests. First, the Court should regard the issue of retroactivity as a question of remedies. Professors Fallon and Meltzer set forth a thorough and balanced discussion of this issue in 104 Harvard L. Rev. 1731 (1990). The Coalition cannot improve on this discussion except to summarize the point that, in a practical sense, the issue of retroactivity is ultimately one of whether relief will be granted or not.

Additionally, by treating retroactivity as a question of remedies, the Court permits the states to go beyond federal limitations in providing remedies to their citizens. See, American Trucking Associations, Inc. v. Smith, 110 S.Ct. at 2348, Stevens, J., dissenting. As this Court has held, principals of comity allow deference to state courts in matters of remedy.

Treating retroactivity as a question of remedies still allows this Court to require retroactive relief to protect federal interests. The Court can hold, as it does implicitly in most cases, that "newness" is not an issue, and retroactivity is required. The Court can also require retroactive relief as an issue of federal remedies. Varying federal interests will result in different applications of federal remedies. In other words, when retroactivity is treated as a remedy, a claimant seeking relief for deprivation of constitutional rights has the opportunity to obtain that relief under both state and federal law.

Without more, this approach might still produce no different results than Chevron, and could thus be subject to the criticism that it encourages judicial lawmaking. The Coalition's response to

this criticism is that the current standard of determining whether a decision is "new" is too loose. It is this "clearly foreshadowed" standard adopted in Chevron and never overruled that encourages outright judicial lawmaking. In the absence of a directly controlling case, almost any decision can be characterized as not clearly foreshadowed.

On this point, the Coalition parts from the conclusion in the analysis of Professors Fallon and Meltzer. To protect stare decisis and recognizing the extraordinarily limited nature prospective only applications should have, the Coalition proposes that the standard be adjusted to the "clear break" standard suggested in American Trucking, 110 S.Ct. at 2334. Unless a case clearly deviates from an established precedent, it cannot be regarded as "new," and the case must be

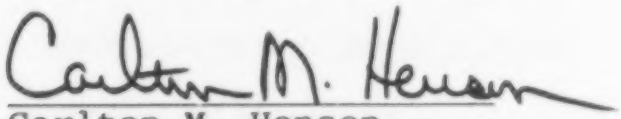
applied retroactively under federal law.

Thus, the proposal of the Coalition would require the Court to first look at whether a decision clearly broke with established authorities. If not, retroactive relief must be available. If there is a clear break, then federal law of remedies applies, and retroactive relief will be available if state or federal law provides it, subject to Due Process requirements. McKesson Corp. v. Florida Alcohol & Tobacco Div., 496 U.S. 18, 110 S.Ct. 2238 (1990). Consistent with Due Process, states can impose procedural limitations.

In the instant case, this Court's decision would clearly break with established precedent but there are no compelling federal interest requiring retroactive relief. Thus, the case should be remanded to the state courts for a

determination of whether state law requires retroactive relief.

Respectfully submitted,



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EXHIBIT A
FULL RETROACTIVE RELIEF DENIED

The cases in these two exhibits were obtained using a Westlaw Quick Cite search of the State Tax Cases database (MTX-CS) using the following query: "(Chevron +3 Oil /s Huson) '404 U.S. 97' '92 S.Ct. 349' & Retroactiv!". Cases that did not address or decide retroactivity were omitted.

Bass v. State, ___ S.E.2d ___, 1992 WL 13852 (S.C. 1992).

Duffy v. Wetzler, ___ N.Y.S.2d ___, 1992 WL 6962 (N.Y.App.Div. 1992).

Sheehy v. State, 820 P.2d 1257 (Mont. 1991).

Harper v. Virginia Dept. of Taxation, 242 Va. 322, 410 S.E.2d 629 (1991).

First Nat. Bank of Eden v. Meyer, 476 N.W.2d 267 (S.D. 1991).

Yount v. Calvert, 1991 WL 176345 (Ky. App. 1991).

American Trucking Associations, Inc. v. McNulty, 596 A.2d 784 (Pa. 1991).

Swanson v. State, 329 N.C. 576, 407 S.E.2d 791 (1991).

Harper v. Virginia Dept. of Taxation, 241 Va. 232, 401 S.E.2d 868 (1991).

Caterpillar, Inc. v. Department of Treasury, 470 N.W.2d 80 (Mich. App. 1991).

Ragsdale v. Department of Revenue, 1990 WL 174474, 11 Or. Tax 440 (1990).

Bass v. State, 302 S.C. 250, 395 S.E.2d 171 (1990).

Cambridge State Bank v. Roemer, 457 N.W.2d 716 (Minn. 1990).

Private Truck Council of America, Inc. v. Oklahoma Tax Comm'n, 806 P.2d 598 (Okla. 1990).

White v. Reynolds Metals Co., 558 So.2d 367 (Ala. Civ. App. 1990).

James B. Beam Distilling Co. v. State, 259 Ga. 363, 382 S.E.2d 95 (1989).

Dennehy v. Department of Revenue, 1989 WL 9252, 11 Or. Tax 191 (1989).

American Trucking Associations, Inc. v. Gray, 295 Ark. 43, 746 S.W.2d 377 (1988).

National Can Corp. v. State, Dept. of Revenue, 109 Wash.2d 878, 749 P.2d 1286 (1988).

Exxon Corp. v. Hunt, 109 N.J. 110, 534 A.2d 1 (1987).

Ashland Oil, Inc. v. Rose, 177 W.Va. 20, 350 S.E.2d 531 (1986).

Federated Mut. Ins. Co. v. DeKalb County, 255 Ga. 522, 341 S.E.2d 3 (1986).

First of McAlester Corp. v. Oklahoma Tax Com'n, 709 P.2d 1026 (Okla. 1985).

Riehm v. Director, Div. of Taxation, 7 N.J. Tax 88 (1984).

Board of Comm'rs of Wood Dale Public Library Dist. v. Du Page County, 103 Ill. 2d 422, 469 N.E.2d 1370 (1984).

Salorio v. Glaser, 93 N.J. 447, 461 A.2d 1100 (1983).

Midway Tobacco Co. v. Mahin, 42 Ill. App. 2d 797, 356 N.E.2d 909 (1976).

EXHIBIT B
FULL RETROACTIVE RELIEF GRANTED

Service Oil, Inc. v. State, 479 N.W.2d 815 (N.D. 1992).

Kay Elec. Co-op. v. State ex rel. Oklahoma Tax Comm'n, 815 P.2d 175 (Okla. 1991).

Allis-Chalmers Corp. v. City of North Bonneville, 113 Wash.2d 108, 775 P.2d 953 (1989).

Ryan v. City of Chicago, 148 Ill. App. 3d 638, 499 N.E.2d 517 (1986).

LaRoque v. State, 178 Mont. 315, 583 P.2d 1059 (1978).

Ralston Purina Co v. Los Angeles County, 56 Cal. App. 3d 547, 128 Cal. Rptr. 556 91976).

FILED
APR 10 1992
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED SIGNAL, INC., as successor-in-interest to The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The Supreme Court Of New Jersey

BRIEF OF THE STATES OF CONNECTICUT, IOWA, MARYLAND, MASSACHUSETTS, MINNESOTA, PENNSYLVANIA AND RHODE ISLAND AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

On March 11, 1992, this Court requested the parties and invited *amici curiae* to simultaneously file briefs addressing the following questions:

1. Should the Court overrule *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If this Court overrules *ASARCO* and *Woolworth*, what constitutional principles should govern state taxation of corporations doing business in several states?

This brief addresses the third question set forth above.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
INTEREST OF *AMICI CURIAE* AND SUMMARY OF ARGUMENT	1
ARGUMENT	4
I. THE UNITARY BUSINESS PRINCIPLE SHOULD BE MODIFIED	4
II. ALL INCOME OF A CORPORATION DOING BUSINESS IN A STATE SHOULD BE SUBJECT TO APPORTIONMENT	6
A. The Linchpin Of Fair Apportionability Is Nexus.	6
B. The Constitution Does Not Require The Piecemeal Exclusion Of Income From a Corporation's Apportionable Income Base	10
C. The Fair Apportionment Of All Income Of A Corporation Doing Business In A State Eliminates Tax Avoidance And Unnecessarily Complex Factual Inquiries	12
CONCLUSION	14

TABLE OF AUTHORITIES

Cases:	Page
Adams Express Co. v. Ohio State Auditor, 166 U.S. 185 (1897)	12
Amerada Hess Corp. v. Director, 490 U.S. 66 (1989)	5
ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982)	*passim*
Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, 266 U.S. 271 (1924)	10
Butler Bros. v. McColgan, 315 U.S. 501 (1942)	10
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)	2
Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983)	5,7,11,12,13,14
Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980)	7,12,14
F.W. Woolworth Co. v. Taxation & Revenue Dept., 458 U.S. 354 (1982)	*passim*
Freeman v. Hewit, 329 U.S. 249 (1946)	8
Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931)	8,11
Miller Bros. v. Maryland, 347 U.S. 340 (1954)	8
Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980)	7,9,13
Moorman Manufacturing Co. v. Blair, 437 U.S. 267 (1978)	8,10,11,13
National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967)	8
National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977)	9
Norfolk & Western Railway Co. v. Missouri State Tax Commission, 390 U.S. 317 (1968)	7,8,9,11
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959)	7,8

Table of Authorities Continued

	Page
Shell Oil Co. v. Dept. of Revenue,488 U.S. 19 (1988)	9
Trinova Corp. v. Michigan Department of Treasury, ___ U.S. ___, 111 S.Ct. 818 (1991)	5,12
U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978)	4
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920)	10,11
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)	8,9,10,14
Laws:	
1987 Laws of Maryland, Ch. 718	4
Md. Ann. Code Art. 81, § 316(a), (b) (1986 Cum. Supp.) (repealed)	4
Rules:	
Sup.Ct.R. 37	1
Sup.Ct.R. 37.5	1

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-615

ALLIED SIGNAL, INC., as successor-in-interest to The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The Supreme Court Of New Jersey

BRIEF OF THE STATES OF CONNECTICUT, IOWA, MARYLAND, MASSACHUSETTS, MINNESOTA, PENNSYLVANIA AND RHODE ISLAND AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

Pursuant to Sup.Ct.R. 37, the signatory states respectfully submit this brief as *amici curiae* in support of Respondent. Because this brief is sponsored and filed by the aforementioned states, consent to its filing is not required. Sup.Ct.R. 37.5.

INTEREST OF *AMICI CURIAE* AND SUMMARY OF ARGUMENT

The question that this brief addresses raises important issues concerning the allocation of the states'

fundamental power to tax income from intangibles held by corporations that exercise the substantial privilege of carrying on business in more than one state.[1] Under the "unitary business principle," each state in which a corporation operates has the right to tax on a fairly apportioned basis the corporation's entire net income from unitary business activities. This principle defines the scope of the states' authority to tax corporations operating in more than one state and, therefore, affects the manner in which *Amici* impose apportioned income taxes based on formulas measuring in-state corporate activities.

This Court's decisions in *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982), illustrate the shortcomings of the unitary business principle with respect to "non-unitary business" income. In allowing a corporation to exclude such income from its apportionable income base notwithstanding that corporation's substantial nexus with the taxing state, these cases assume that the Constitution requires the states to specifically connect each item of income to the corporation's intrastate activities. That requirement is constitutionally unsound and economically unrealistic, is unnecessarily

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[1] In the interest of judicial economy, *Amici* address only the third question set forth in this Court's March 11, 1992 Order. *Amici* support and adopt the arguments of *amicus* California urging the Court to overrule its decisions in *ASARCO* and *Woolworth*. *Amici* also support and adopt the arguments of *amicus* Virginia urging that the principles of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), be retained to determine whether a decision overruling *ASARCO* and *Woolworth* should apply retroactively; those principles dictate that such a decision should be retroactive.

complex to administer, and enables corporations to escape their full obligation to pay for protections, opportunities and benefits received in all states in which they operate.

The Constitution conditions a state's power of taxation only on the existence of a minimal connection or nexus between that state and a corporation's interstate activities. If that requirement is met, a state should be allowed to tax that corporation's entire income, provided that the resulting tax is reasonably related to the business transacted in that state. This approach offers a bright-line test that greatly simplifies the ultimate question of defining the taxable income base; eliminates the complex factual inquiries that must presently be made under the unitary business principle; and harmonizes tax consequences by treating in the same manner differing categories of income which are constitutionally and economically indistinguishable.

Amici's position is, in its most basic formulation, that income is income and that it matters neither in a constitutional nor an economic sense whether that income is produced by the sale of a product, by the licensing of technology that enables another entity to sell that product, by the investment of the income generated by those selling or licensing activities, or by the gain on the sale of the investment. *Amici* urge adoption of a rule of full apportionment of all corporate income subject only to the constitutional requirement that there exist both a minimal connection between the taxing state and a corporation's activities within that state and a rational relationship between

the income attributed to the taxing state and the intrastate values of the corporation.[2]

ARGUMENT

I. THE UNITARY BUSINESS PRINCIPLE SHOULD BE MODIFIED.

The unitary business principle is a federal judicial concept initially applied to sustain apportioned state taxation of interstate railroad property. The concept was later extended to state corporate income taxes where it has been used for two distinct purposes: (1) to measure the entire net income of a single corporation from all activities deemed to constitute a part of a single unitary business enterprise; and (2) to combine the income of two or more separate corporations deemed to constitute a single business enterprise. *See U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 n. 25 (1978).

The unitary business principle was originally designed to respond to the difficulty inherent in identifying the geographic source of the income earned

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[2] Maryland law, for example, provides for full apportionment subject to the limitations set forth above. Rental income from real and personal property and capital gain income from sales of real and personal property are now included within the taxable income base of a corporation doing business in Maryland, while previously that income was removed from the corporation's base if the property in question had a situs in another state. Similarly, capital gain income from the sale of intangibles is included within the corporate taxable base whereas previously that income was excluded if the corporation had a commercial domicile in another state. *See* 1987 Laws of Maryland, Ch. 718; Md. Ann. Code Art. 81, § 316(a), (b) (1986 Cum. Supp.) (repealed).

by a multistate enterprise. *See Trinova Corp. v. Michigan Department of Treasury*, ___ U.S. ___ , 111 S.Ct. 818, 829 (1991). Factors contributing to this difficulty include functional integration, centralization of management and economies of scale. *Id.* at 832. Courts have accordingly developed the unitary business principle which

> rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction.

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 165 (1983).

Under the unitary business principle, as currently understood by the Court, the fact that the source of particular income may be ascertained by separate geographical accounting is constitutionally irrelevant. As long as the income-producing activity is part of a unitary business, the income is includable in the apportionable income base. *See Trinova*, 111 S.Ct. at 831; *Amerada Hess Corp. v. Director*, 490 U.S. 66, 73 (1989) (fact that activity occurring entirely outside the state is conducted by a unitary business subjects resulting income to taxation). So stated, and as so limited, the principle is a sound and workable one.

In *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982), however, this Court expanded the principle to remove income from intangibles from the corporations' apportionable income base because it found no unitary business relationship between the income-payors and the income-recipients. For the reasons stated below, that expansion of the principle demands more than the Constitution requires, ignores economic realities, and virtually assures that a significant portion of a corporation's income will not be taxed by the states even though that corporation receives benefits in each state in which the corporation conducts its business.

This Court has never suggested that a purchaser of a product must be unitary with the seller for a state to tax income from that sale. There should similarly be no restrictive unitary requirement for other types of income. As long as a state has a minimum connection or nexus with a corporation's interstate activities, that state should be permitted to fairly apportion all of that corporation's income. *Amici* urge that the unitary business principle be modified to focus solely on the activities of the taxpayer and not on the identities or activities of those who pay the taxpayer income.

II. ALL INCOME OF A CORPORATION DOING BUSINESS IN A STATE SHOULD BE SUBJECT TO APPORTIONMENT.

A. The Linchpin Of Fair Apportionability Is Nexus.

This Court has recognized that the "entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas uti-

lizing in-state aspects of interstate affairs." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959). The states' ability to apportion that income hinges on whether there exists "a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 436-37 (1980).

The unitary business principle should not, however, be "the linchpin of apportionability for state income taxation of an interstate enterprise. . . ." *F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. at 362, quoting *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 223 (1980), in turn quoting *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. at 439. Rather, as long as "the tax is fairly apportioned to the commerce carried on within the State," "the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State." *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. 317, 325 n. 5 (1968). The linchpin of fair apportionability, therefore, is the " 'nexus' between the interstate activities and the taxing State. . . ." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 165-66, quoting *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. at 219-20.

Absent that nexus, a state has no right to apportion any income. " 'Taxable event', 'jurisdiction to tax', 'business situs', 'extraterritoriality', are all compendious ways of implying the impotence of state power

because state power has nothing on which to operate." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). "And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the 'simple but controlling question is whether the state has given anything for which it can ask return.' " *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967), quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444. Similarly, "the Court has held that 'State taxation falling on interstate commerce * * * can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys.' " *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. at 756, quoting *Freeman v. Hewit*, 329 U.S. 249, 253 (1946).

Under either the Due Process Clause or the Commerce Clause, however, if a state has established "some definite link, some minimum connection, between [that] state and the person, property or transaction it seeks to tax," *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954), that state has the power to tax "the *entire* net income of a corporation. . . ." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. at 460 (emphasis added).

Of course, "the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.' " *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 273 (1978), quoting *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. at 325. The Constitution thus proscribes a state's attempt to levy a tax that is "out of all appropriate proportion to the business transacted . . . in that state." *Hans Rees' Sons, Inc. v.*

North Carolina ex rel. Maxwell, 283 U.S. 123, 135 (1931).

But it is the method used in apportioning that income and levying that tax, and not the unitary business principle, that ensures that a tax has not "resulted in such gross overreaching . . . as to violate the Due Process and Commerce Clauses of the Constitution." *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. at 326. *See also Shell Oil Co. v. Dept. of Revenue*, 488 U.S. 19, 30-31 (1988) (mere inclusion of income in preapportioned tax base does not establish extraterritorial taxation). As far as a state's power of taxation is concerned, once "[t]he requisite 'nexus' is supplied if the corporation avails itself of the 'substantial privilege of carrying on business' within the State . . . '[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction.' " *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. at 437, quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444-45. There is, and should be, *no* nexus requirement with respect to a particular transaction, such as a sale of stock; the Constitution is satisfied by the demonstrated nexus of the taxpayer to the taxing state. *See National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 560 (1977) ("The Society argues in other words that there must exist a nexus or relationship not only between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the seller's activity within the State. We disagree.").

B. The Constitution Does Not Require The Piecemeal Exclusion Of Income From A Corporation's Apportionable Income Base.

Once a nexus exists between a corporation and the taxing state, no constitutional purpose is served in allowing that corporation to specifically exclude from its apportionable income base on an itemized basis dividends, capital gains or other types of income allegedly unrelated to the corporation's presence in the taxing state. To the contrary, the Constitution requires only that an *estimate* of a corporation's business be attributed to the taxing state and that a fairly designed apportionment formula be utilized to assure that there is a *reasonable* relationship between the income to be taxed and the in-state values of the taxpayer.[3] Permitting a corporation to exclude income

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[3] In confirming the inexact science of imposing a tax on "[t]he substantial privilege of carrying on business," *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444-45, this Court has recognized the "impossibility" inherent in any attempt to mathematically calculate income attributable to intrastate activities: "a State in attempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' " *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942), quoting *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920). Because of this impossibility, "the States have wide latitude in the selection of apportionment formulas," *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 274, which need only result in a "*rough* approximation of a corporation's income that is *reasonably* related to the activities conducted within the taxing State." *Id.* at 273 (emphases added). The Constitution "is certainly not more exacting." *Butler Bros. v. McColgan*, 315 U.S. at 506. *See also Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266

from an apportionment formula because *that* income allegedly is not related to the corporation's presence in the taxing state is flatly inconsistent and irreconcilable with this Court's refusal to invalidate apportionment formulas or their application merely because they "will not produce a figure that represents the actual profits earned within the State" and, in fact, "will occasionally over-reflect or under-reflect income attributable to the taxing State." *Moorman Manufacturing Co. v. Bair*, 437 U.S. 273.

Because the Constitution is not offended by "the substantial margin of error inherent in any method of attributing income among the components of a unitary business," *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 184, a corporation cannot have a constitutional right to remove any one type of income from its apportionable income base. It may be that a state's apportionment of a corporation's entire income will not have an exacting result with respect to business conducted in that state. But a similar "risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income." *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 278. In neither case does that mean that the resulting tax is grossly out of proportion to the business transacted in a state, *see Hans Rees' Sons, Inc. v. North Carolina*

U.S. 271 (1924). Therefore, a corporation is constitutionally entitled to show only "that the method of apportionment adopted by the state was inherently arbitrary," *Underwood*, 254 U.S. at 121 (footnote omitted), or that its application "led to a grossly distorted result." *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. at 326. The Constitution does not mandate any more "precision in interstate taxation." *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 278.

ex rel. Maxwell, 283 U.S. at 135, or that there is no " 'rational relationship' between the income attributed to the State by the apportionment formula and the intrastate value of the business." *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. at 226-27.

C. The Fair Apportionment Of All Income Of A Corporation Doing Business In A State Eliminates Tax Avoidance And Unnecessarily Complex Factual Inquiries.

Including all of a corporation's income in the apportionable income base thus creates no unconstitutional risk of distortion or extraterritorial taxation. Adjustments to the apportionment formula are the appropriate remedy for such concerns, which the taxpayer must prove by clear and cogent evidence. *See Trinova Corp. v. Michigan Dept. of Treasury*, 111 S.Ct. at 832. Conversely, allowing corporations to exclude income from that base creates a significant opportunity for—and greatly encourages—tax avoidance because it will "eliminate from the reach of the taxing power a large portion of the wealth of the country." *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185, 219 (1897).

"The first . . . component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the . . . business income being taxed." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 169. But this fairness works both ways. Excluding from the apportionable income base income such as capital gains or dividends reaped from investments in "discrete enterprises," *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. at 320, will result in less than all of a corporation's income being

taxed because many states where corporations have a business situs or commercial domicile apportion such income.[4] Prohibiting corporations from excluding that income from their apportionable base ensures that that income will not escape taxation, thus resulting in no more *and* no less than all business income being taxed. *See Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 169.

Including all income within the apportionable base also eliminates the need for state tax officials to unravel the complexities of multistate, multinational, multicorporate transactions and engage in the highly factual and often subjective inquiries that the unitary business principle requires. These complicated inquiries include ascertaining whether "there was centralization of management or achievement of other economies of scale," *F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. at 366, or "a highly integrated business which benefits from an umbrella

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[4] This Court "has recognized that 'the reason for a single place of taxation no longer obtains' when the taxpayer's activities with respect to intangible property involve relations with more than one jurisdiction," and that "cases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the apportionment principle prevails." *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. at 445 (citations omitted). Thus, "[s]ome States do not distinguish between business and nonbusiness income for apportionment purposes." *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 279. Corporations with a business situs or commercial domicile in full apportionment states such as Maryland, *see* n. 2 *supra*, will thus escape taxation if the intangible income from a non-unitary source is held to be constitutionally immune from the tax on an apportioned basis. Such a result is particularly inappropriate given the Court's stated preference to avoid the "single place of taxation" concept.

of centralized management and controlled interaction," *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. at 319, quoting *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. at 224, or "some sharing of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation. . . ." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 166.[5]

The only question that should be asked is whether a minimal connection or nexus exists between the corporation's interstate activities and the taxing state so that "the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444. If it does, there should be no constitutional obstacle to the fair apportionment of all income of that corporation.

CONCLUSION

For the reasons stated in the supplemental briefs of New Jersey and other *amici* who support Respondent, this Court should overrule *ASARCO* and *Woolworth*; reinstate the *Chevron Oil* test for determining whether a decision should apply retroactively; and apply its decision in this case retroactively. For the reasons set forth above, the following principles should govern the taxation of corporations doing busi-

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[5] The Herculean efforts which New Jersey was compelled to undertake to establish Bendix's history of acquisitions and the reasons therefor best illustrate these complexities. There is little benefit to a constitutional rule that virtually requires a corporation's chief executive officer to be deposed by every state that seeks to tax that corporation's income from intangibles.

ness in several states: the linchpin of apportionability in the field of state income taxation is the presence of constitutional nexus, *i.e.*, a minimal connection between the corporation's activities and the taxing state. If that nexus exists, all income of the corporation is subject to tax in that state on a fairly apportioned basis. Income is income, and the Constitution does not require different tests for taxing different types of income.

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Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

IN THE SUPREME COURT
OF THE UNITED STATES
OCTOBER TERM, 1991

ALLIED-SIGNAL, INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the
Supreme Court of New Jersey

AMICUS CURIAE BRIEF OF THE CITY OF NEW YORK IN SUPPORT OF RESPONDENT

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TABLE OF CONTENTS

Table of Authorities ii

Cases ii

Other Authorities and statutes iii

Interest of the Amicus Curiae 1

ARGUMENT

SINCE THE DUE PROCESS CLAUSE OF THE CONSTITUTION REQUIRES ONLY A "MINIMAL CONNECTION" BETWEEN A BUSINESS AND THE TAXING JURISDICTION IN ORDER TO SUBJECT ITS ENTIRE INCOME TO APPORTIONMENT, THE DECISIONS IN ASARCO, INC. v. IDAHO STATE TAX COMMISSIONER, 458 U.S. 307 (1982), and F.W. WOOLWORTH CO. v. TAXATION & REVENUE DEPT., 458 U.S. 354 (1982), WHICH PERMIT TAXATION OF INVESTMENT INCOME ONLY IF ITS SOURCE IS A "FUNCTIONALLY INTEGRATED BUSINESS, SHOULD BE OVERRULED.... 6

CONCLUSION 18

TABLE OF AUTHORITIES

Cases	Page
Allied Signal, Inc. v. Commissioner of Finance, 79 NY2d 73 (1991)	15
ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) .....passim	
Butler Brothers v. Mc Colgan, 315 U.S. 501 (1942	10
Chevron Oil v. Huson, 404 U.S. 97 (1971)	17
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).....	6,7
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) .....passim	
Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980)	7
F.W. Woolworth Co. v. Taxation & Revenue Dep't,458 U.S. 254 (1982)....passim	
Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931)	10
International Harvestor Co. v. Wisconsin Department of Taxation, 322 U.S. 435 (1944)	8
Mobil Oil Corp. v. Commissioner of Taxes 445 U.S. 425 (1980) .....passim	
Northwest States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1958) ...	8

Wallace v. Hines, 253 U.S. 66 (1920) ... 12

Washington Department of Revenue v. Association of Washington Stevedoring Cos., 435 U.S. 734 (1978) 8

Western Live Stock v. New Mexico Bureau of Revenue, 303 U.S. 250 (1938) ... 8

Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940) 9

Wisconsin v. Minnesota Mining and Manufacturing, 311 U.S. 452 (1940)..... 9

Statutes

New York City Administrative Code §11-601, et seq. 2

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On Writ of Certiorari to the
Supreme Court of New Jersey

AMICUS CURIAE BRIEF OF THE CITY OF NEW YORK IN SUPPORT OF RESPONDENT

Interest of the Amicus Curiae

Pursuant to Rule 37.5, the City of New York, as a political subdivision of the State of New York, is exercising the right to file a brief amicus curiae in support of the position of the Respondent, Director, Division of Taxation.

Pursuant to the Administrative Code of the City of New York §11-601 et seq., New York City imposes a General Corporation Tax on the "entire net income" of all corporations, domiciliary and non-domiciliary, which conduct business within the City. "Entire net income" includes both "business income" and "investment income". Although both types of income are taxed at the same rate, they are allocated to the City by different procedures in order to exclude from the tax base all income earned through non-City business activity.

A taxpayer with a regular place of business outside the City is entitled to allocate its business income through use of a "business allocation percentage" ("BAP"). The BAP is itself the average of three ratios: (i) the ratio of the taxpayer's New York City receipts to its total receipts, (ii) the ratio of the value of the taxpayer's New York City property to the total value of its property, and (iii) the ratio of the

taxpayer's New York City salaries and wages to its total salaries and wages. The taxpayer's total business income multiplied by its BAP results in the taxpayer's New York City business income, which is subject to tax. This formula is widely used in state taxation as an index of in-state business activity and has been accepted as a "benchmark" by this Court in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 170 (1983).

Corporate taxpayers are also entitled to allocate investment income between New York City and non-City sources. For this purpose, the taxpayer's total investment income is multiplied by an "Investment Allocation Percentage" ("IAP"). The IAP is the average, of the issuer's allocation percentage of each of the entities in which the taxpayer has invested its capital, weighted according to the value of each investment.

The determination of a taxpayer's IAP may be illustrated as follows: Assume that a taxpayer has invested $1,100,000 in corporations "A", "B", and "C". Also assume that the taxpayer's investment in "A" is valued at $200,000, its investment in "B" at $300,000, and its investment in "C" at $600,000; and that "A's" New York City issuer's allocation percentage is 40%, "B's" is 15%, and "C's" is 10%. The sum of each of the taxpayers's investments multiplied by the respective issuer's allocation percentage is $185,000 [($200,000 x 40%) + ($300,000 x 15%) + ($600,000 x 10%)]. That amount ($185,000) is then divided by the sum of the taxpayer's total investments ($1,100,000), yielding the taxpayer's IAP (16.8%).

Determination of the issuer's allocation percentage depends upon the type of entity the issuer is considered for purposes of the City's corporate franchise tax. For general business

corporations, the issuer's allocation percentage is based on its the ratio of capital in the City, the components of which are business, investment, and subsidiary capital, to its total capital. In order to assist taxpayers, the City publishes each year a table of the issuer's allocation percentages for corporate securities. The product of the taxpayer's total investment income and the taxpayer's IAP is the amount of investment income included in the taxpayer's New York City tax base.

This investment allocation procedure, by considering solely the payor's allocation percentage, limits the City's tax to the taxpayer's share of the stream of income resulting from the payor's capital in New York City.

ARGUMENT

SINCE THE DUE PROCESS CLAUSE OF THE CONSTITUTION REQUIRES ONLY A "MINIMAL CONNECTION" BETWEEN A BUSINESS AND THE TAXING JURISIDICTION IN ORDER TO SUBJECT ITS ENTIRE INCOME TO APPORTIONMENT, THE DECISIONS IN ASARCO, INC. v. IDAHO STATE TAX COMMISSIONER, 458 U.S. 307 (1982), and F.W. WOOLWORTH CO. v. TAXATION & REVENUE DEPT., 458 U.S. 354 (1982), WHICH PERMIT TAXATION OF INVESTMENT INCOME ONLY IF ITS SOURCE IS A "FUNCTIONALLY INTERGRATED" BUSINESS, SHOULD BE OVERRULED.

(a)

A state or locality may impose taxes on corporations engaged in interstate commerce as long as there is no discrimination against out-of-state taxpayers and such taxes are properly related to income-producing activities within the taxing jurisdiction. Complete Auto Transit v. Brady, 430 U.S. 274, 279 (1977). This Court has repeatedly held that a non-discriminatory tax on corporate income is subject to constitutional prohibition only where

the taxpayer can show by "clear and cogent evidence" that the tax is imposed on income with no nexus to the taxing jurisidiction. Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 164 (1983); Exxon Corporation v. Wisconsin Department of Revenue, 447 U.S. 207, 221 (1980). Container Corporation offered the following statement of the governing legal principles (463 U.S. at 164):

> Under both the Due Process and the Commerce Clause of the Constitution, a state may not, when imposing an income-based tax, tax value earned outside its borders. In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. For this reason and others, we have long held that the Constitution imposes no single formula on the States, and that the taxpayer has the distinct burden of showing clear and cogent evidence that the state tax results in extraterritorial values being taxed.

The principles governing taxation of corporate business income, frequently delineated

by this Court, flow logically from the fundamental prohibition against taxation of extra-territorial income. It is well settled that a state may tax receipts or income directly resulting from the taxpayer's in-state activities. Washington Department of Revenue v. Association of Washington Stevedoring Cos., 435 U. S. 734 (1978); Western Live Stock v. New Mexico Bureau of Revenue, 303 U.S. 250 (1938). In the case of a multi-state enterprise, a state may tax its properly apportioned share of the enterprise's total income. Northwest States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1958).

All income, regardless of its source, may also be taxed by apportioned methods which avoid taxation of extraterritorial income. This Court approved apportioned taxation of corporate investment income in a series of decisions concerning a Wisconsin dividend tax. International Harvester Co. v. Wisconsin

Department of Taxation, 322 U.S. 435 (1944); Wisconsin Department of Taxation v. J.C. Penney, Inc., 311 U.S. 435 (1940); Wisconsin v. Minnesota Mining and Manufacturing, 311 U.S. 452 (1940).

(b)

We submit that, since the sole requirements of the Due Process clause are a nexus between the taxing jurisdiction and either the taxpayer or the income, and fair apportionment of the taxable income, the unitary business principle imposed by ASARCO, Inc. v. Idaho State Tax Commissioner, 458 U.S. 307, reh'g denied, 459 U.S. 961 (1982), and F.W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354, reh'g denied, 459 U.S. 961 (1982), serves no constitutional purpose and ought not be applied in determining the reach of a jurisdiction's taxing authority. A corporation should be considered in its totality, inclusive of income from all sources, whether

active or passive, whether generated inside or outside the taxing jurisdiction as long as it is fairly apportioned to its intrajurisdictional activities or values. The unitary business principle, as applied in ASARCO and Woolworth, encourages an unrealistic fragmentation of the corporate entity, unwieldy in application, constitutionally unwarranted, and totally unnecessary in order to achieve equity in taxation.

This Court has consistently considered all aspects of a complex business enterprise as a single organic entity. In Butler Brothers v. McColgan, 315 U.S. 501, 508 (1942), the Court, quoting from Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123, 133 (1931), stated: "The enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." In Mobil Oil Corp.

v. Commissioner of Taxes, 445 U.S. 425, 438 (1980), the Court stated that "factors of profitability arise from the operation of the business as a whole...". ASARSO and Woolworth are aberrations from this otherwise consistent treatment of a business enterprise.

The dissenting opinion of Justice O'Connor in ASARCO, Inc. v. Idaho State Commissioner, 458 U.S. 307, 331 (1982), while discussing due process requirements within the context of the unitary business principle, points toward the abandonment of the principle itself rather than merely criticizing the majority's application of it to the facts in ASARCO and Woolworth. In support of her assessment that the majority had negatively impacted upon the delicate balances involved in fiscal policy-making and had "'imprison[ed] the taxing power of the states within formulas that are not compelled by the Constitution'" [citing Wisconsin v. J.C. Penney Co., 311 U.S. 435, 445 (1940)], Justice

O'Connor recognized that "a multijurisdictional business is 'an organic system', Wallace v. Hines, 253 U.S. 66, 69 (1920) (Holmes, J.), whose income cannot sensibly be reduced to the sum of the hypothetical incomes of distinct component parts, each wrenched from the unitary whole and conceptually confined to operations within a single State." 458 U.S. at 332-333.

In arguing that ASARCO had failed to meet its burden of demonstrating that the tax levy upon its investments was unconstitutional, Justice O'Connor stated (458 U.S. at 337-338):

> [A]ssuming, arguendo, that the contested investments were in fact passive, ASARCO has failed to show that its holdings were divorced from its management of the financial requirements of its nonferrous metals business. For all we know, ASARCO's investments were triggered by its need to obtain a return on idle financial resources accumulated for the future operation of its own primary business.
>
> ASARCO does not, and could not, contend that all its investment income is per se beyond the taxing power of the nondomiciliary States in which it

operates. Rather, it concedes that the Due Process Clause permits Idaho to tax, on an apportioned basis, the income ASARCO earned on short-term investments of its working capital. After all, an appropriate amount of liquid working capital is necessary to the day-to-day operation of a business, and any return earned from its temporary investment is a byproduct of the operation of the business. ASARCO thus admits that Idaho could tax a portion of the income realized from an investment in, say, short-term commercial paper, even though the underlying operations of the issuing companies were far less related to ASARCO's nonferrous metals business than the operations of the five subsidiaries at issue here.

The interim investment of retained earnings prior to their commitment to a major corporate project, however, merely recapitulates on a grander scale the short-term investment of working capital prior to its commitment to the daily financial needs of the company. Just as companies prefer to maintain a cushion of working capital rather than resort to the short-term capital markets on an hourly basis for the money necessary to operate their businesses, many enterprises prefer to acquire the capital necessary for the expansion and replacement of plants and equipment by creating long-term funds, rather than resort to the vagaries of the capital markets. In order to prevent the accumulating capital from sitting idle, such funds are usually invested in financial assets

> with a degree of liquidity appropriate to the money's intended ultimate use. Any return ASARCO earned on such investments plainly would be functionally related to the conduct of its non-ferrous metals business and, therefore, taxable by Idaho on an apportioned basis as unitary business income.

By imposing limitations on state and local taxing authorities not required by the Due Process clause, the Court may have been trying to prevent potential systemic inequities. The remedy, however, should not be sought in the guise of constitutional restraints which, in reality, unconstitutionally interfere with the legitimate reach of the states' power to tax. Where significant inequities arise, remedies less drastic than the erection of constitutional barriers are available. Once a nexus with a corporation is established, the Due Process clause permits the state to levy a tax on all the income of the business as long as it is properly apportioned.

(c)

The Due Process and Commerce clauses require that nexus exist between the entity or income sought to be taxed and the taxing jurisdiction. In upholding the City's method of taxing corporations, the New York Court of Appeals recently stated: "Nowhere did the [Supreme] Court indicate that it intended that the existence of a unitary business relationship would be the exclusive means for satisfying the nexus requirement when a State or municipality sought to tax the investment income that a nondomiciliary corporation earned." (emphasis in original). Allied Signal, Inc. v. Commissioner of Finance, 79 NY2d 73, 81 (1991). As explained supra, pp. 2-5, the City's General Corporation Tax imposes a tax on investment income based on the taxpayer's investment allocation percentage, which itself is based on the relationship the issuers of the securities, in which the taxpayer has invested, have to the

City. Under the City's conservative tax system, there must not only be nexus between the City and the taxpayer, but also nexus between the City and the investment income. Whether a unitary business exists between the income and the nondomiciliary taxpayer need not be considered under the City's methodology.

As indicated above, we respectfully urge this Court to overrule ASARCO and Woolworth because the Due Process clause imposes no constitutional requirement that a unitary relationship exist before a state or municipality can reach the investment income of a nondomiciliary. The constitutional principal that governs state taxation of multijurisdictional corporations is solely nexus between the entity to be taxed and the jurisdiction seeking to tax it. Once the fundamental requirement of nexus is met, the method devised by the state or municipality to tax the income of the nondomiciliary corporation must exhibit a

rational relationship to the intrajurisdictional values of the corporation. But, within that framework, jurisdictions should be afforded the widest latitude in fashioning a method of apportionment which reaches only those intrajurisdictional values.

(d)

Because of the unique circumstances of ASARCO and Woolworth, their overruling was clearly foreshadowed, even at the time they were rendered, and was effectively accomplished by Container Corporation v. Franchise Tax Board, 463 U.S. 159 (1983). We endorse the position set forth by Amici Virginia, et al., to be filed concurrently with our brief, that Chevron Oil v. Huson, 404 U.S. 97 (1971), provides the appropriate standard for resolving retroactivity. The Chevron standards for retroactive application of the overruling of ASARCO and Woolworth are met.

CONCLUSION

THE DECISIONS OF THIS COURT IN ASARCO AND WOOLWORTH SHOULD BE OVERRULED, AND THE JUDGMENT BELOW SHOULD BE AFFIRMED AND GIVEN RETROACTIVE EFFECT.

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Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615 (21)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL, INC., as successor-in-interest to THE BENDIX CORPORATION,

Petitioner,

v.

DIRECTOR, Division of Taxation,

Respondent.

On Writ of Certiorari to the Supreme Court Of the State of New Jersey

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BRIEF OF *AMICI CURIAE* IN SUPPORT OF PETITIONER BY AMERICAN HOME PRODUCTS CORPORATION, ASARCO INCORPORATED, AVON PRODUCTS, INC., COLGATE-PALMOLIVE CORPORATION, GENERAL MILLS, INC., GEORGIA-PACIFIC CORPORATION, HOUSEHOLD INTERNATIONAL, INC., ICI AMERICAS INC., JAMES RIVER CORPORATION OF VIRGINIA, THE MEAD CORPORATION, NCR CORPORATION, PHILLIPS PETROLEUM COMPANY, PREMARK INTERNATIONAL, INC., RJR NABISCO HOLDINGS CORPORATION, SAFEWAY INC., SCOTT PAPER COMPANY, AND SQUARE D COMPANY

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QUESTIONS PRESENTED

1. Should the Court overrule *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

TABLE OF CONTENTS

	Page
INTRODUCTORY STATEMENT	1
INTEREST OF *AMICI CURIAE*	2
SUMMARY OF ARGUMENT	2
ARGUMENT	4
I. THE COURT SHOULD NOT OVERRULE *ASARCO* AND *WOOLWORTH* BECAUSE, IN ASKING THE COURT TO DO SO, NEW JERSEY EFFECTIVELY ASKS THE COURT TO DESTROY THE "UNITARY BUSINESS PRINCIPLE" AND TO ESTABLISH A NEW RULE THAT WOULD ALLOW A TAXING STATE TO APPORTION *ALL* INCOME RECEIVED BY A NON-DOMICILIARY CORPORATION DOING BUSINESS WITHIN ITS BORDERS	4
A. The "Unitary Business Principle" Gives Effect to the Due Process and Commerce Clause Requirement That a Taxing State May Only Tax a Non-Domiciliary Corporation on the Portion of Its Income That Is Fairly Attributable to Its Activities Within the State	5
B. New Jersey's Position Would Destroy the Unitary Business Principle and Allow States to Apportion Income Unrelated to the Taxpayer's In-State Activities	9
C. Rather Than Destroy the Unitary Business Principle as New Jersey Seeks To Do, This Court Should Reaffirm That the Unitary Business Principle Requires, in Each Case, a Factual Analysis of the Relationship Between the Activities Giving Rise To the Intangible Income and the Taxpayer's Activities in the Taxing State	14

II. IN THOSE CASES WHERE A NON-DOMICILIARY STATE IS PERMITTED TO APPORTION INTANGIBLE INCOME RESULTING FROM AN EQUITY INVESTMENT IN THE UNDERLYING BUSINESS OF ANOTHER CORPORATION, THE COURT SHOULD CLARIFY THAT IT IS UNCONSTITUTIONAL FOR THE STATE TO DO SO BASED ON THE STANDARD, THREE-FACTOR FORMULA, WHICH TAKES INTO ACCOUNT ONLY THE TAXPAYER'S SEPARATE PAYROLL, PROPERTY, AND SALES AND DOES NOT REFLECT THE FACTORS OF THE UNDERLYING BUSINESS THAT GAVE RISE TO THE INTANGIBLE INCOME 16

A. The Court Should Clarify That "Gross Distortion" in the Traditional, Quantitative Sense Is Not Required in Order to Show That a Conceptually Flawed Formula is Unconstitutional 22

B. The Court Should Clarify That These Principles Apply to Capital Gains and Other Forms of Intangible Income As Well As to Dividends 23

C. In View of the Foregoing, Overruling *ASARCO* and *Woolworth* Would Entail More Administrative Complexity, Not Less 24

III. IF *ASARCO* AND *WOOLWORTH* WERE OVERRULED, THE COURT SHOULD CLARIFY THE PRINCIPLES NECESSARY TO AVOID DUPLICATIVE STATE TAXATION ... 25

A. Duplicative Taxation of "Non-Business" Income 26

B. Duplicative Taxation of Business Income 29

CONCLUSION 30

TABLE OF AUTHORITIES

CASES: Page

Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 6,12,n.8;14

American Home Products Corp. v. Director, Div. of Taxation, 11 N.J. Tax 287 (1990), appeal docketed, No. A-4316-90T3 (N.J. Super. Ct. App. Div., May 2, 1991) 13,16,16,n.11;21,n.15;24

Amer. Tel. & Tel. v. Dept. of Revenue, 143 Wis.2d 533, 422 N.W.2d 629 (Wis. Ct. App. 1988) ... 21

ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) 2,4,11,*passim*

Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) 14

Butler Bros. v. McColgan, 315 U.S. 501 (1942) 18

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 17

Container Corp. v. Franchise Tax Bd., 463 U.S. 159 (1983) 5,n.1;6,22,23,*passim*

Corning Glass Works v. Va. Dept. of Tax., 402 S.E.2d 35 (Va. 1991), *cert. denied*, ___ U.S. ___ (1991) 20,21,22

Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980) 14

F.W. Woolworth Co. v. Taxation & Revenue Dept., 458 U.S. 354 (1982) 2,4,*passim*

Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931) 5,22,23

Homart Dev. Co. v. Norberg, 529 A.2d 115 (R.I. 1987) 21

International Paper Co. v. Director, Div. of Taxation, 11 N.J. Tax 147 (1990), *aff'd.*, N.J. Super. Ct. App. Div., No. A-5138-89T5 (May 13, 1991), *certif. denied*, N.J. Super. Ct., No. 33,784 (Oct. 18, 1991) 13,20,21,n.15;22

Table of Authorities Continued

Page

Kraft General Foods, Inc. v. Iowa Dept. of Rev. and Fin., 465 N.W.2d 664 (Iowa 1991), *petition for cert. filed* (No. 90-1918) 15,n.10

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) .. 3,5,6,7,8,18,n.13;19,19,n.14,23,26,27,29,*passim*

NCR Corp. v. South Carolina Tax Com'n, 402 S.E.2d 666 (S.C. 1991) 21,24

NCR Corp. v. Commissioner of Revenue, 438 N.W.2d 86 (Minn. 1989) 16,n.11;22

NCR Corp. v. Comptroller, 313 Md. 118, 544 A.2d 764 (1988) 21

Pledger v. Illinois Tool Works, Inc., 812 S.W.2d 101 (Ark. 1991), *cert. denied*, ___ U.S. ___ (1991) . 20

Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039 (Me. 1991) 20

Trinova Corp. v. Michigan Treas. Dept., 498 U.S. ___, 112 L.E.2d 884 (1991) 5,n.1;7

Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920) 3,5,6,23

Wallace v. Hines, 253 U.S. 66 (1920) 6

CONSTITUTION OF THE UNITED STATES:

Commerce Clause, art. I, § 8 ..... 3,15,n.10;*passim*

Due Process Clause, amend. XIV, § 1 ..... 3,*passim*

STATUTES:

N.J.S.A. § 54:10A-4(k) 28

N.J.S.A. § 54:10A-6 28

N.J.S.A. § 54:10A-8 ..... 21,n.15

Uniform Division of Income for Tax Purposes Act, sections 4, 6(c), and 7 ..... 26,n.16

MISCELLANEOUS:

Pierce, William J., *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747 (1957) 26,n.16

State Tax Guide, Vol, 1, ¶ 10-110 (CCH) 28

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-615

ALLIED-SIGNAL, INC., as successor-in-interest to THE BENDIX CORPORATION,

Petitioner,

v.

DIRECTOR, Division of Taxation,

Respondent.

On Writ of Certiorari to the Supreme Court Of the State of New Jersey

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BRIEF OF *AMICI CURIAE* IN SUPPORT OF PETITIONER BY AMERICAN HOME PRODUCTS CORPORATION, ASARCO INCORPORATED, AVON PRODUCTS, INC., COLGATE-PALMOLIVE CORPORATION, GENERAL MILLS, INC., GEORGIA-PACIFIC CORPORATION, HOUSEHOLD INTERNATIONAL, INC., ICI AMERICAS INC., JAMES RIVER CORPORATION OF VIRGINIA, THE MEAD CORPORATION, NCR CORPORATION, PHILLIPS PETROLEUM COMPANY, PREMARK INTERNATIONAL, INC., RJR NABISCO HOLDINGS CORPORATION, SAFEWAY INC., SCOTT PAPER COMPANY, AND SQUARE D COMPANY

INTRODUCTORY STATEMENT

This brief is submitted by *amici curiae* ("*amici*") in support of petitioner in the above-captioned case. Written con-

sents of the petitioner and respondent have been obtained and are filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

Amici are domestic corporations engaged in business, either directly or indirectly through subsidiaries, throughout the United States and in foreign countries. As such, their business income is subject to apportionment and taxation by non-domiciliary States.

Amici receive intangible income, including dividends, interest, royalties, and capital gains. The fact patterns giving rise to their receipt of intangible income vary. Where *amici* conduct their business activities in multi-corporate form, they commonly receive intangible income in connection with their unitary subsidiaries. In addition, *amici* commonly make investments, including, in some cases, equity investments in unrelated corporations whose activities are functionally unrelated to the unitary business operations of *amici*.

In view of the foregoing, *amici* are concerned about the apportionment and taxation of their intangible income by non-domiciliary States. If *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982), were overruled, *amici* are concerned that *all* of their intangible income would be apportionable by non-domiciliary States. In addition, *amici* are concerned about the apportionment formulas used by non-domiciliary States to apportion intangible income. Finally, *amici* are concerned about the duplicative taxation by domiciliary and non-domiciliary States that could result from inconsistent allocation and apportionment standards.

SUMMARY OF ARGUMENT

New Jersey's position in this case has ramifications far beyond merely overruling *ASARCO* and *Woolworth*. New Jersey effectively asks the Court to destroy the long-standing "unitary business principle" established by the Court

to effectuate the Due Process and Commerce Clause requirement that States only tax a non-domiciliary corporation on income that is fairly related to the corporation's activities in the taxing State. New Jersey's definition of a unitary business would allow a non-domiciliary State to apportion *all* income received by the corporation, regardless of whether the income has any relation to the corporation's activities in the State, thereby allowing the State to tax extraterritorial values.

Rather than adopt New Jersey's unitary business definition, the Court should reaffirm a unitary business test that turns on whether the activities giving rise to the income in issue are related to the taxpayer's activities in the taxing State. Under such a test, as the Court recognized in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), *ASARCO*, and *Woolworth*, intangible income attributable to a taxpayer's equity investment in the underlying business of another corporation generally would not be apportionable if that underlying business were unrelated to the taxpayer's activities in the taxing State. Application of the unitary business test would require a different factual inquiry when other types of intangible income are in issue.

If *ASARCO* and *Woolworth* were overruled, it will be even more important for the Court to clarify that apportionment of intangible income will not meet Due Process and Commerce Clause standards where, as here, the intangible income and the apportionment factors used to apportion that income are conceptually incommensurate. In this case, the intangible income (the capital gain) was attributable to an equity investment in the underlying business of *ASARCO*, but the apportionment factors in the formula reflected only Bendix' separate payroll, property, and sales, and did not reflect ASARCO's factors that gave rise to the intangible income. The Court should make clear that, regardless of the amount of distortion created, such apportionment formulas are "inherently arbitrary", *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), and will be invalidated if not modified. The Court also should confirm that the apportionment formulas must be modified

to reflect the factors giving rise to other types of intangible income. Consequently, New Jersey's unitary business test would increase, not reduce, administrative complexity since more intangible income would become apportionable and, as a result, there would be more instances requiring modification of the apportionment formula.

Finally, if *ASARCO* and *Woolworth* were overruled, the Court should clarify that the same intangible income cannot be both allocated to the State of commercial domicile (as "non-business income") and apportioned by non-domiciliary States (as unitary business income). Similarly, the Court should provide guidance to avoid duplicative taxation of business income as a consequence of inconsistent unitary business tests.

This *amicus* brief does not address the Court's second question concerning retroactivity.

ARGUMENT

I. THE COURT SHOULD NOT OVERRULE *ASARCO* AND *WOOLWORTH* BECAUSE, IN ASKING THE COURT TO DO SO, NEW JERSEY EFFECTIVELY ASKS THE COURT TO DESTROY THE "UNITARY BUSINESS PRINCIPLE" AND TO ESTABLISH A NEW RULE THAT WOULD ALLOW A TAXING STATE TO APPORTION *ALL* INCOME RECEIVED BY A NON-DOMICILIARY CORPORATION DOING BUSINESS WITHIN ITS BORDERS.

When the Court ordered supplemental briefs addressing the question whether the Court should overrule *Asarco Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) ("*ASARCO*"), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982) ("*Woolworth*"), it did not ask whether the "unitary business principle" should be overruled. However, that is what New Jersey effectively asks the Court to do. The implications of New Jersey's position go far beyond just the *ASARCO* and *Woolworth* decisions. New Jersey's position in this case would effectively destroy the long-standing "unitary business principle."

A. The "Unitary Business Principle" Gives Effect to the Due Process and Commerce Clause Requirement That a Taxing State May Only Tax a Non-Domiciliary Corporation on the Portion of Its Income That Is Fairly Attributable to Its Activities Within the State.

"[T]he linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980) ("*Mobil*"). Furthermore, the "unitary business principle" has been the "linchpin" of apportionability in an unbroken, consistent line of decisions of this Court going back over more than 70 years.[1]

There is an important reason for the development of the unitary business principle. In cases where a State seeks to tax income of a non-domiciliary corporation[2] that conducts business both within and without the State, the unitary business principle gives effect to the Due Process and Commerce Clause requirement that the State's taxing scheme "reach only the profits earned within the state." *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 133 (1931), quoting *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

When a business' in-state activities and out-of-state activities are sufficiently integrated so that the income from the in-state activities cannot be accounted for or determined separately from the income from the out-of-state activities (*i.e.*, when "the intrastate and extrastate activities form[ed] part of a single unitary business", *Mobil*, 445 U.S. at 438),

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[1] *See*, cases cited in *ASARCO*, 458 U.S. at 320, n.14. Since the *ASARCO* decision, the Court has continued to affirm the unitary business principle. *See, e.g., Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983), and *Trinova Corp. v. Michigan Treas. Dept.*, 498 U.S. ____, 112 L.Ed. 2d 884 (1991).

[2] As used hereinafter, the term "non-domiciliary corporation" means a corporation that is doing business within the taxing State, but is both organized under the laws of, and has its headquarters or commercial domicile in, some other State.

formulary apportionment has been permitted. As the Court stated in *Mobil* (445 U.S. at 438):

> In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.

Thus, "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders", *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. at 121, the taxing State may use formulary apportionment to measure that portion of the income from the unitary business that is fairly attributable to its in-state activities.

The State still is limited, however, to taxing only the income earned by the in-state activities; that constitutional limitation never changes. As the Court noted in *Wallace v. Hines*, 253 U.S. 66, 69 (1920), "The only reason for allowing a state to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it." Similarly, formulary apportionment "calculates the local tax base" of a multi-jurisdictional unitary business. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 165 (1983) ("*Container*").

In "defining the scope of the 'unitary business'" (*Container*, 463 U.S. at 165), wholly-separate or discrete activities, unrelated to the activities in the taxing State, are not taken into account. For example, in *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897), the Court noted that unity of ownership alone was insufficient to justify apportionment, stating (165 U.S. at 222):

> The same party may own a manufacturing establishment in one state and a store in another, and may make profit by operating the two, but the work of each is separate. The value of the factory in itself is not conditioned on that of the store, or *vice versa*, nor is the value of the goods

> manufactured and sold affected thereby. The connection between the two is merely accidental and growing out of the unity of ownership.

In such a case, where the in-state activities and the out-of-state activities are unrelated, it is inappropriate to take those out-of-state activities into account in measuring the income attributable to the separate activities in the taxing State. As Justice Stevens noted in his dissent in *Mobil* (445 U.S. at 453):

> The justification for using an apportionment formula to measure the in-state earnings of a unitary business is inapplicable to out-of-state earnings from a source that is unconnected to the business conducted within the State.

Thus, the "unitary business principle" assures that inclusion of an item of income in the apportionable income base is permitted *only* where appropriate to measure the taxable income attributable to activities in the taxing State. Otherwise, as the Court noted in *Trinova Corp. v. Michigan Treas. Dept.*, 498 U.S. ___, 112 L.E.2d, 884, 904:

> . . . to allow apportionment where there is no practical or theoretical justification could provide the opportunity for a state to export tax burdens and import tax revenues.

Using the example discussed during oral argument in this case on March 4, 1992, if a taxpayer domiciled in New York operates beauty parlors in New York and New Jersey and a parking lot in California, and if it is assumed that the beauty parlors and the parking lot are not parts of a single unitary business, New Jersey may not include any income from the California parking lot in apportionable income.

Moreover, the decisions in *Mobil*, *ASARCO* and *Woolworth*, are perfectly consistent with all of the Court's prior unitary business cases. *Mobil*, *ASARCO*, and *Woolworth* merely applied accepted unitary business principles where the income in issue was intangible income attributable to

business activities that were owned indirectly through equity interests in separate corporations.[3] Because an equity investment in a corporation's stock represents an indirect interest in the underlying business of the corporation, the *Mobil*, *ASARCO*, and *Woolworth* decisions correctly resolved whether the dividends and other intangible income were apportionable by looking to whether the underlying activities of the separate corporations were unitary with the activities of the taxpayer-recipient corporations in the taxing States. Thus, applying established unitary business principles, the Court held in *Mobil* that dividends received from unitary subsidiaries should be included in apportionable income, stating (445 U.S. at 440-441):

> But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise. Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from those divisions would meet due process requirements for apportionability. Cf. *General Motors Corp. v. Washington*, 377 U. S. 436, 441 (1964). Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives. (Footnote omitted.)

Applying the same principle in *ASARCO* and *Woolworth*, the Court held that the income was not includible in apportionable income because the business activities conducted by the payor-corporations were not part of the taxpayers' unitary businesses. These decisions correctly reflect the *Mobil* principle that the "form of business organization" should not dictate the result. If the profits of a business operated

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[3] *Mobil* only involved dividends. *ASARCO* involved dividends, capital gains, and interest, and *Woolworth* involved dividends and gross-up. *See*, *ASARCO*, 458 U.S. at 330, and *Woolworth*, 458 U.S. at 372.

as a division of the taxpayer are not apportionable, because that business is not part of the taxpayer's unitary business, incorporating the division as a subsidiary should not change the result. Dividends thereafter paid by the subsidiary to the taxpayer, or capital gains realized by the taxpayer on the sale of the subsidiary's stock, should not be apportionable because they are generated by the same underlying business, which is not part of the taxpayer's unitary business. Thus, *ASARCO* and *Woolworth* merely represent the logical application of the unitary business principle in cases involving intangible income from equity interests in unrelated corporations.

As will be seen below, New Jersey's position in this case is inconsistent, not only with the results in *ASARCO* and *Woolworth*, but also with the Court's long-standing unitary business principle. Consequently, New Jersey's attempt to overrule *ASARCO* and *Woolworth* is, effectively, an attempt to do far more than just overrule those cases. As is discussed below, New Jersey seeks to destroy the unitary business principle that is at the very heart of the Due Process and Commerce Clause restrictions prohibiting a State from apportioning income that has no relation to activities conducted in the State.

B. New Jersey's Position Would Destroy the Unitary Business Principle and Allow States to Apportion Income Unrelated to the Taxpayer's In-State Activities.

In asking the Court to overrule *ASARCO* and *Woolworth*, New Jersey seeks to shift the traditional unitary business focus away from how income is earned (*i.e.*, whether the income in issue was earned jointly by both in-state and out-of-state activities operating together as a unit). Under New Jersey's approach, all activities are part of a taxpayer's unitary business if they contribute to the taxpayer's "overall profitability" or "growth." (Br. for Resp. p. 25). Thus, on the facts of this case, New Jersey argued that the ASARCO stock investment furthered Bendix' corporate objectives of

growth and diversification. (Br. for Resp. 25, 28; Tr. 39).[4] Moreover, during oral argument before this Court, counsel for New Jersey also argued that it is not even necessary to demonstrate the actual unitary relationship in each case, stating (Tr. 38):

> MS. HAMILL: Because it seems to me that once it's in the same corporate shell, once it's being managed by the same corporate management, it's being—there have to be flows of value. You have to assume that they're there. We can't delve into these facts in every one of these cases. It's an unworkable proposition.

New Jersey's unitary business test is inconsistent with all of the Court's unitary business decisions and would destroy the unitary business principle. First, New Jersey's test is inconsistent with the historic purpose for the unitary business principle, as discussed in Part A, *supra*. The New Jersey test would permit apportionment of income without regard to whether it was necessary in order to measure the income from activities within the State. Thus, even though the ASARCO gain did not in any way reflect the income earned by Bendix' New Jersey activities, New Jersey would include the gain in apportionable income simply because that gain might be used in the future to expand the unitary business.

The proper focus of the unitary business test should remain on how the income was earned, not whether the income may be reinvested to expand the business *after* it is earned.[5] Income currently earned by the unitary business

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[4] "Tr." references are to the official transcript of the oral argument before this Court on March 4, 1992.

[5] It is important to emphasize that New Jersey's test turns on potential, future benefits to the business. Investing funds for *possible future capital expansion* of a business is far different from holding funds as working capital in the *current operation* of the business. Since working capital is currently employed in the business, there is a sufficient, currently-existing relationship between the temporary investment of the working capital and the in-state activities to justify apportioning the intangible

is apportionable among the jurisdictions in which the business is conducted, regardless of whether that income ultimately may be distributed as a dividend, invested in a separate business, or used to expand the business in only one of those jurisdictions. The future use of the income is irrelevant.

By contrast, simply because a source of funds is used for future capital expansion of the business does not mean it is earned in the business and is apportionable to those jurisdictions where it may be invested.[6] Viewing money as a fungible commodity, *all receipts* (including non-taxable loans) from any source will provide some benefit to all businesses conducted by a single taxpayer, whether those businesses are discrete or unitary under the Court's prior decisions. If this alone were sufficient to make the taxable receipts apportionable, there would be no need to apply the unitary business principle in *any* case—whether it involved operating income (as in the Court's earlier decisions) or intangible income (as in *Mobil*, *ASARCO*, and *Woolworth*).

As the Court recognized in *ASARCO*, relying on such tenuous benefits to define a unitary business (458 U.S. at 326):

> [W]ould destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the

---

income from that investment. By contrast, there is no such current operational connection or relationship between the investment of funds not yet employed in the business and the in-state activities.

[6] Basing the test on the intended use of the funds also is unworkable since intentions may change. For example, in this case, some of the ASARCO gain was used to retire Bendix' outstanding stock, rather than to expand the business. (J.A. 183).

> "unitary business" limitation becomes no limitation at all.

If income is unitary whenever it may potentially be used in a taxpayer's business, then all income is apportionable. If New Jersey's unitary business test were adopted, there could never be a separate or discrete business activity. The California parking lot, discussed *supra*, was assumed to be non-unitary. But, under New Jersey's test, it always would be unitary with the New York and New Jersey beauty parlors because the income from the parking lot could potentially be used in the beauty parlor business.[7]

Finally, absent any functional relationship, the mere fact that the ASARCO stock diversified Bendix' core businesses cannot make the income unitary. It would be perverse indeed to justify unitary treatment of two separate and discrete businesses on the basis that those businesses are different.

The irreconcilable conflict between New Jersey's view of the unitary business relationship and the prior decisions of this Court setting forth the unitary business principle was clearly revealed during the prior oral argument (Tr. 31-33):

> QUESTION: I guess I don't know what you mean by a unitary business. I guess—is every business that's owned by the same company part of a unitary business?
>
> MS HAMILL: Yes.[8]
>
> QUESTION: Is that the only condition?
>
> MS. HAMILL: Yes. We would say because—

---

[7] Nor, for the reasons discussed, *supra*, would there be any merit to New Jersey's position if it were to argue that its position only applies to intangible income and not to income earned from operation of the parking lot directly. Under *Mobil*, the corporate form chosen for operating the California parking lot should make no difference.

[8] This answer by itself shows that more is at stake than just the decisions in *ASARCO* and *Woolworth*. This answer is in conflict with this Court's decision in *Adams Express Co.*, in which the Court noted that ownership alone was not sufficient to justify apportionment.

> QUESTION: So there's really no inquiry to be made at all.
>
> MS. HAMILL: That's—yes—
>
> QUESTION: So long as it's owned by the same corporation.
>
> MS. HAMILL: Yes, that's right. . .

Nor is this an isolated case. The destruction of the unitary business principle under New Jersey's approach also is illustrated by the position New Jersey argued unsuccessfully in other cases. *See, e.g., International Paper Co. v. Director, Div. of Taxation*, 11 N.J. Tax 147, 164 (1990), *aff'd.*, N.J. Super. Ct. App. Div., No. A-5138-89T5 (May 13, 1991), *certif. denied*, N.J. Super. Ct., No. 33,784 (Oct. 18, 1991) (New Jersey argued that International Paper's gain on its sale of a minority stock interest was unitary income because the stock was "capable of being pledged, liquidated, or converted to other uses."); *American Home Products Corp. v. Director, Div. of Taxation*, 11 N.J. Tax 287, 302, 304, 307 (1990), appeal docketed, No. A-4316-90T3 (N.J. Super. Ct. App. Div., May 2, 1991) (New Jersey argued that American Home Product's dividends and capital gain from minority stock interests, and its interest income, were unitary business income, citing as support for its position, the commingling of the investment income with general operational funds).

In *ASARCO* and *Woolworth*, this Court rejected the approach New Jersey takes here because that approach would destroy the unitary business principle, which effectuates the long-standing Due Process and Commerce Clause restraint on state taxation of non-domiciliary corporations. The Court should reject New Jersey's approach in this case for the same reason.

C. Rather Than Destroy the Unitary Business Principle as New Jersey Seeks To Do, This Court Should Reaffirm That the Unitary Business Principle Requires, in Each Case, a Factual Analysis of the Relationship Between the Activities Giving Rise To the Intangible Income and the Taxpayer's Activities in the Taxing State.

In determining whether the income in issue in a particular case is apportionable, the Court should preserve a unitary business test that turns on how the income is earned. The Court should clarify that income is apportionable only where the activities giving rise to the income are part of the same unitary business that includes the taxpayer's activities in the taxing State.

This is an inherently factual test and turns on far more than mere ownership or the fact that the income ultimately may be invested in the business *after* the income has been received. For example, where the manufacturing activities and the store discussed in *Adams Express Co.*, 165 U.S. 194, were unrelated, they were not considered to be parts of the same unitary business despite the fact that they were both owned by the taxpayer. By comparison, where operations are functionally integrated, there would be a single unitary business. *See, e.g., Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980) (integrated petroleum business); *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924) (integrated manufacture and sale of ale).

In determining whether the activities giving rise to intangible income are part of the unitary business, the application of the test should turn, among other things, on the type of intangible income in issue. Where, as in *Mobil*, *ASARCO*, *Woolworth*, and the instant case, the income is attributable to an equity investment in the underlying business of another corporation, the test should turn generally on the relationship between the underlying activities of that

corporation and the taxpayer's activities in the taxing State.[9] After all, the equity investment represents an indirect ownership of those underlying activities, and the amount of the income turns on the success of those activities. Any other test would exalt form over substance.

Presumably, a different factual inquiry would be made with respect to other types of intangible income, such as royalties and interest. Where the royalties and interest are received from unitary subsidiaries, the unitary business test would be satisfied.[10] *Amici* recognize that royalties and interest also may be apportionable even if received from unrelated third parties, as long as the activities giving rise to the royalties and interest are part of the taxpayer's unitary business (*e.g.*, royalties from licensing intangibles developed in the business or interest earned from the temporary investment of working capital held for use in the business).

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[9] *ASARCO* and *Woolworth* have been criticized as looking solely to the underlying activities of the payor corporations. *Amici* do not contend that this general rule should apply in every equity investment case. For example, a broker-dealer who holds shares of stock as inventory for sale to customers in the ordinary course of its business may not look for its income to the underlying activities of the corporations whose stock it buys and sells. Like any other dealer, the income will be earned from selling the inventory to the customers.

But such cases are distinguishable, and have nothing to do with the instant case. In this case, Bendix intended to invest in and acquire an indirect ownership of the underlying business of ASARCO and was looking to the success of ASARCO's business (particularly an anticipated increase in the value of ASARCO's copper deposits) for a return on its investment. (J.A. 98-101, 123-125, 241). There was *no* operational connection between the investment and Bendix' separate activities.

[10] If foreign unitary subsidiaries are involved, there may be other constitutional objections arising under the Foreign Commerce Clause to including dividends, interest, or royalties in apportionable income. *See, e.g.*, the issues raised in *Kraft General Foods, Inc. v. Iowa Dept. of Rev. and Fin.*, 465 N.W.2d 664 (Iowa 1991), *petition for cert. filed* (No. 90-1918), which is currently pending before the Court. Other Foreign Commerce Clause issues have been raised in other cases. But, for purposes of this case, the unitary business test would be satisfied, and it would not be a basis for excluding the income from apportionable income.

By the same token, as in *American Home Products Corp.*, 11 N.J. Tax 287, it also is possible, based on the facts of the particular case, that interest income may be attributable to investment activities totally unrelated to the taxpayer's unitary business activities in the taxing State. Interest income was unrelated in *American Home Products*, because the investment portfolio involved greatly exceeded the working capital needs of the business and the activities with respect to the portfolio were conducted entirely outside the taxing state.

Accordingly, in view of the foregoing, *amici* urge the Court to reaffirm the unitary business principle established in *ASARCO*, *Woolworth*, and *all* of its other unitary business cases.

II. IN THOSE CASES WHERE A NON-DOMICILIARY STATE IS PERMITTED TO APPORTION INTANGIBLE INCOME RESULTING FROM AN EQUITY INVESTMENT IN THE UNDERLYING BUSINESS OF ANOTHER CORPORATION, THE COURT SHOULD CLARIFY THAT IT IS UNCONSTITUTIONAL FOR THE STATE TO DO SO BASED ON THE STANDARD, THREE-FACTOR FORMULA, WHICH TAKES INTO ACCOUNT ONLY THE TAXPAYER'S SEPARATE PAYROLL, PROPERTY, AND SALES AND DOES NOT REFLECT THE FACTORS OF THE UNDERLYING BUSINESS THAT GAVE RISE TO THE INTANGIBLE INCOME.[11]

In judging whether a taxpayer's apportionable income is

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[11] Question 3 posed by the Court requested a discussion of the constitutional principles that should govern state taxation of corporations doing business in several states if *ASARCO* and *Woolworth* were overruled. Part II is of great importance to *amici* even if *ASARCO* and *Woolworth* are not overruled, since the apportionment of intangible income received from admittedly unitary subsidiaries is a very significant problem and has spawned a significant amount of litigation. If *ASARCO* and *Woolworth* were overruled, this problem would simply be exacerbated.

Nor are apportionment issues limited to just the apportionment of intangible income attributable to equity investments as is involved in this

"fairly apportioned" *(Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 279 (1977)), to the taxpayer's in-state activities, this Court set forth the applicable test in *Container*, as follows (463 U.S. at 169-170):

> [A]n apportionment formula must, under both the Due Process and Commerce Clauses, be fair [Citations omitted.] The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State . . . ." [Citations omitted.] Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' [citation omitted] or has 'led to a grossly distorted result.'" [Citation omitted.] (Emphasis added by Court.)

New Jersey's apportionment formula flunks this test with respect to intangible income from an equity investment in the underlying business of another corporation, because the apportionable income base and the apportionment factors

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case. *See, e.g., NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989) (State taxed a share of dividends, interest, and royalties received from foreign unitary subsidiaries), and *American Home Products Corporation v. Director, Div. of Taxation*, 11 N.J. Tax 287 (1990) (State attempted to tax a share of investment income attributable to an investment portfolio). In both cases, the States refused to modify their formulas to account for the nature of the intangible income in issue.

used to apportion that base are conceptually incommensurate. For example, the base in this case includes approximately $211,500,000 of gain resulting from Bendix' investment in the underlying business of ASARCO (J.A. 6), whereas the apportionment factors are limited to only Bendix' separate payroll, property, and sales. The property, payroll, and sales of ASARCO that increased the value of its stock and gave rise to the gain New Jersey seeks to tax are not reflected in the factors.[12] Thus, whereas the record shows that the investment was made in large part because of Bendix' desire to acquire an interest in ASARCO's copper deposits (J.A. 98-101, 123-125, 241), the value of ASARCO's copper deposits, which were located outside of New Jersey (J.A. 164), is not reflected in Bendix' separate property factor.

Under these circumstances, the factors used in the formula (*i.e.*, Bendix' separate factors) clearly do not "reflect a reasonable sense of how [the capital gain was] generated," as required by the *Container* test. Nor, if the ASARCO capital gain is apportionable, do Bendix' separate factors alone properly "reflect the relative contribution of the activities in the various states [in this case, New Jersey] to the production of the total unitary income." *Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942).[13] Justice Stevens

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[12] Bendix' capital gain was included by New Jersey in the denominator of the sales factor, but that gain is conceptually far different from ASARCO's underlying gross receipts or sales. (J.A. 205). Moreover, there was no adjustment to the payroll or property factors. Such an adjustment to the sales factor alone is completely inadequate to reflect the payroll, property, and sales that gave rise to the income (*i.e.*, the capital gain) being apportioned.

[13] Apportioning intangible income in this fashion also is inconsistent with the principle in *Mobil* that the form of the taxpayer's corporate organization should not dictate the result. 445 U.S. at 441. If International Paper's Canadian operations had been conducted as a division, the Canadian factors would have been taken into account. In either case, the income attributable to International Paper's activities in New Jersey should be the same.

recognized the inherent unconstitutionality of such a situation in his dissent in *Mobil*,[14] noting (445 U.S. at 459, 461):

> [I]t is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income.
>
> * * *
>
> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

This case is a dramatic example. Bendix initially apportioned $56,835,028 of operating income on its state tax return. (J.A. 202). The State added $267,351,914 of capital gain and interest income (including the ASARCO gain of $211,513,354 in issue here) to the apportionable income base. As a result of the ASARCO stock sale alone, apportionable income was increased from approximately $57 million to approximately $268 million, almost a five-fold increase. This increased amount should not be apportioned to New Jersey on the basis of the factors used to apportion Bendix' separate operating income. Bendix' operations in New Jersey consisted primarily of its aerospace activities in Teterboro, New Jersey and the manufacture of electric power generating systems at Eatontown, New Jersey. (J.A. 161-163). Under the State's formula, ASARCO's copper deposits caused these aerospace and manufacturing activities to be treated as being very profitable indeed.

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[14] This question of fair apportionment was identified but left unresolved by the Court in *Mobil* because the issue had not been raised. *Mobil*, 445 U.S. at 434, 441, n.15, and 449. Justice Stevens, in his dissenting opinion in *Mobil* (445 U.S. at 449-462), addressed the merits of this issue.

This case makes it is plain that a formula such as New Jersey's is conceptually flawed (because of the conceptual inconsistency between the apportionable tax base and the apportionment factors) and inevitably taxes income not earned by the taxpayer's in-state activities. Consequently, the formula is never "fair" under the constitutional test of *Container*.

Nor is this case in any way atypical. *Amici* routinely are confronted with such overreaching by the States. *See also*, *International Paper Co.*, 11 N.J. Tax 147 (1990); *Pledger v. Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark. 1991), *cert. denied*, ___ U.S. ___ (1991); and *Corning Glass Works v. Va. Dept. of Tax.*, 402 S.E.2d 35 (Va. 1991) *cert. denied*, ___ U.S. ___ (1991), all involving attempts by the States to apportion, on the basis of the taxpayers' separate apportionment factors, substantial amounts of capital gains from equity investments in the businesses of other corporations. *International Paper* is a particularly egregious example. In *International Paper*, New Jersey succeeded in including in apportionable income over $500 million of capital gain from the sale of a Canadian subsidiary, while successfully excluding from the apportionment formula all of the underlying Canadian factors that gave rise to the gain.

Some state court decisions have recognized the States' overreaching in these circumstances. For example, in *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991), Maine sought to include dividends from foreign unitary subsidiaries in apportionable income without also including the associated payroll, property, and sales of the subsidiaries in the apportionment factors. The court concluded that this approach was unconstitutional, stating (595 A.2d at 1044):

> The ineluctable result is that more of the business activity of the unitary business is attributed to Maine than is the actual case. Thus, the income taxable by Maine under the Assessor's formula does not truly reflect Tambrands' connection with Maine and fails to meet the test of fairness required by the due process clause.

See also, NCR Corp. v. South Carolina Tax Com'n, 402 S.E.2d 666 (S.C. 1991) (involving royalties and interest from unitary subsidiaries); *Amer. Tel. & Tel. v. Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629, 636 (Wis. Ct. App. 1988), (involving dividends from unitary subsidiaries); *NCR Corp. v. Comptroller*, 313 Md. 118, 544 A.2d 764 (1988), (involving dividends and royalties from unitary subsidiaries); and *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987) (involving distributive share of income from a partnership).

Notwithstanding these decisions, the practical reality confronted by *amici* is that the state taxing authorities are intransigent in their efforts to exploit these unfair formulas. For example, at the oral argument in this case, counsel for New Jersey acknowledged that (Tr. 48) "one problem with the three factor formula as it now works is that it doesn't include intangible property at all." Nonetheless, counsel justified excluding the intangible property in this case from the formula because (Tr. 48):

> It was not big enough to create much difference in New Jersey in this tax year, but in some years it can.[15]

In addition, counsel rejected Justice Stevens' statement in his dissent in *Mobil* that the payroll, property, and sales of the dividend-paying corporation should be included in the factors when dividends are included in the apportionable base. (Tr. 48). Similarly, in an *amicus* brief filed by 20 States in support of Virginia's petition for *certiorari* in *Corning Glass Works*, the States acknowledged (p. 12, n.6) Justice Stevens' suggestion for factor modification with respect to dividends, but said factor modification should not

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[15] This apparent concession by counsel that modification of the formula would be warranted in some circumstances is of no solace to *amici*. Although New Jersey's statute permits such exercise of discretion (N.J.S.A. 54:10A-8), the State's practice in this regard is demonstrated by its failure to do so in the instant case, *International Paper*, and *American Home Products*. Modification of the formula clearly was warranted in the instant case and in *International Paper* and would have been warranted in *American Home Products* if the court had held the investment income at issue to be apportionable.

be required in *Corning Glass Works* since that case involved capital gains.

A complete response to these points by counsel for New Jersey and the *amici* States in *Corning Glass Works* is beyond the scope of this brief. Three brief points, however, are warranted to show the need for this Court's ultimate intervention with respect to this issue.

A. The Court Should Clarify That "Gross Distortion" in the Traditional, Quantitative Sense Is Not Required in Order to Show That a Conceptually Flawed Formula is Unconstitutional.

Counsel's comment (Tr. 48) about whether it would "create much difference" if the formula were modified is very significant. States commonly defend conceptually indefensible apportionment of intangible income on the ground that the amount of resulting distortion is within constitutional limits—as purportedly established by the opinions of this Court. *See, e.g., NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989), in which the court upheld Minnesota's apportionment of intangible income from foreign unitary subsidiaries without factor modification even though a distortion of 23% was acknowledged. The court did so on quantitative grounds, stating (438 N.W.2d at 93):

> [T]o justify a finding of impermissible external inconsistency, any alleged distortion must be demonstrated to be outside the "substantial margin of error." *Container Corp.*, [citation omitted]

The New Jersey Tax Court took the same quantitative approach in *International Paper*, 11 N.J. at 165-167. Similarly, in this case, petitioner's alternative argument for a modification of the formula was denied. (Pet. App. 22a-24a.)

It is critically important for the Court to address this constitutional distinction between intangible income cases (which involve inherently unfair formulas that do not reflect all of the factors that give rise to the income being apportioned) and prior cases like *Container* and *Hans Rees & Sons* (which involve formulas that do reflect all of the fac-

tors). The defective formulas in the intangible income cases always produce distortion and systematically apportion to the in-state activities income earned by the factors not reflected in the formula. Since such formulas are "inherently arbitrary" (*Underwood Typewriter*, 254 U.S. at 121), they should, without more, be invalidated. There can never be a "rational relationship between the income attributed to the State [by such a formula] and the intrastate values of the enterprise" as required by the Due Process Clause. *Mobil*, 445 U.S. at 437. Nor can such a formula be "fair" or satisfy the internal or external consistency tests enunciated in *Container*, 463 U.S. at 169-170.

In *Hans Rees & Sons*, the Court stated (283 U.S. at 133):

> [W]hen the state has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases.

The Court should now clarify that such proof is unnecessary when the State has adopted a formula that *is* "intrinsically arbitrary."

B. The Court Should Clarify That These Principles Apply to Capital Gains and Other Forms of Intangible Income As Well As to Dividends.

Initially, it should be plain that dividends and capital gains from the sale of stock are conceptually inseparable. Both represent income that is attributable to an equity interest in the underlying business of another corporation (the "underlying business"). Dividends constitute earnings of the underlying business that have been distributed. Capital gains on disposition of the equity interest represent earnings of the underlying business that have not yet been distributed or unrealized appreciation in the value of the assets of that business. In either event, the taxpayer's income is generated by the property, payroll, and sales of the underlying business, not by the taxpayer's separate property, payroll, and sales. In this case, the capital gain resulted from ASARCO's business, including its copper holdings.

Where the equity interest giving rise to the apportionable dividends or capital gain is in a subsidiary corporation whose underlying activities are part of the taxpayer corporation's unitary business (as in *Mobil*), *amici* believe that the apportionment factors should be modified to include an appropriate portion of the subsidiary's payroll, property, and sales. If *ASARCO* and *Woolworth* were overruled so that dividends and capital gains attributable to non-unitary corporations also were apportionable, *amici* recognize that the information necessary to make such a modification may not, as a practical matter, be available. In that event, some alternative approach may be constitutional. But, it still would be unconstitutional to fail to make any modification of the formula whatsoever. Indeed, if no modification were made, that alone would be an independent constitutional basis for excluding the income from the apportionable base. The overriding constitutional principle is that there be a conceptual correlation between the apportionable income and the factors used to apportion that income.

The same principle also applies to other forms of intangible income, although, again, different fact patterns may call for different approaches to modifying the apportionment formula. For example, as recognized by the South Carolina Supreme Court, interest and royalties from foreign unitary subsidiaries also are generated by the payroll, property, and sales of those subsidiaries. *NCR Corp. v. South Carolina Tax Com'n*, 402 S.E.2d at 673-674. The apportionment formula should reflect that fact.

A different approach may be called for if the Court approved apportionment of investment income like that at issue in *American Home Products Corp.*, where substantial intangible investment income, far beyond the working capital needs of the business, was generated by the management of the intangible investments outside the taxing State.

C. In View of the Foregoing, Overruling ASARCO and Woolworth Would Entail More Administrative Complexity, Not Less.

During the oral argument (as discussed *infra* at p. 28),

counsel for New Jersey justified the State's unitary business test, in part, on the ground that it would simplify the administrative process and reduce the factual development currently required to determine whether there is a unitary business. As the foregoing demonstrates, New Jersey's position would increase administrative burdens.

If more intangible income were apportionable, there would be a correspondingly increased need to modify the State's apportionment factors. Furthermore, in view of Parts IIA and IIB, *supra*, States should not be able to avoid such modification by contending that the resulting distortion was not too great, or that modification only is required with respect to dividends.

Finally, as discussed *supra*, the appropriate modification in each case would turn on an analysis of the facts in that case. If the intangible income were received from unitary subsidiaries (as determined under traditional unitary concepts), the modification should take into account an appropriate portion of the subsidiaries' payroll, property, and sales. Thus, it still would be necessary to make the unitary business inquiry that New Jersey seeks to avoid. If other types of intangible income were involved, still other factual inquiries would be called for.

III. IF *ASARCO* AND *WOOLWORTH* WERE OVERRULED, THE COURT SHOULD CLARIFY THE PRINCIPLES NECESSARY TO AVOID DUPLICATIVE STATE TAXATION.

During oral argument, counsel for New Jersey was questioned about duplicative taxation if *ASARCO* and *Woolworth* were overruled. (Tr. 41-44). There are two aspects to this concern. First, insofar as New Jersey's position destroys the unitary business principle and, consequently, the concept of "non-business" income, there is the question of duplicative taxation of intangible income of the type that traditionally has been treated as non-business income. The State of commercial domicile may choose to tax 100 percent

of such income as non-business income,[16] and non-domiciliary States may seek to tax the same income on an apportioned basis. This circumstance (allocation and apportionment of the same income) is a problem that *amici* already have had to confront. If *ASARCO* and *Woolworth* were overruled, the problem could become more severe as the non-domiciliary States expanded their taxing power.

Second, insofar as New Jersey's position destroys the concept of a single corporation engaging in two or more separate unitary businesses, there is also the prospect of New Jersey apportioning to itself income that another State may claim is attributable to the activities of a separate business conducted in its jurisdiction. We consider these two circumstances separately.

A. Duplicative Taxation of "Non-Business" Income.

In theory, both allocation and apportionment of non-business income should not occur. If an item of income truly is earned by the unitary business, it is apportionable and cannot also be allocated as non-business income. The Court considered precisely this issue in *Mobil*. In *Mobil*, the taxpayer objected to Vermont's attempt to apportion the dividends there in issue on the grounds that (1) the dividends were fully allocable to New York, the State of commercial domicile, and (2) the same income could not be taxed on both an apportioned and a fully allocated basis. The Court agreed with the second proposition, stating (445 U.S. at 444-445):

> Taxation by apportionment and taxation by allocation to a single situs are theoretically incom-

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[16] Traditionally, the State of commercial domicile has been permitted to allocate to itself capital gains and losses with respect to intangible personal property, interest, and dividends to the extent they constitute "non-business" income. *See, e.g.*, the Uniform Division of Income for Tax Purposes Act, sections 4, 6(c) and 7. The primary draftsman of UDIPTA explained that these provisions were adopted because they "generally follow the prevailing rules now applied by the several states." Pierce, William J., *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 749 (1957).

> mensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained. See *Standard Oil Co. v. Peck*, 342 U.S. 382, 384 (1952).

Thus, the income may not be apportioned by a non-domiciliary State *if* it is fully allocable to a single state.

Amici also wish to clarify that it is immaterial for this purpose if, as in this case, the State of commercial domicile did not, in fact, allocate all of the income in issue to itself. The taxing jurisdiction of one State does not expand or contract depending on another State's decision to exercise the full extent of its taxing power. The Court also confirmed this point in *Mobil*, stating (445 U.S. at 444):

> We agree with Mobil that the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy.

If the Court were to overrule *ASARCO* and *Woolworth*, the Court should reaffirm that the same income may not be both allocated and apportioned. The Court should clarify that any new standard of unitary income is binding on all States.

But, even that would not fully address the other serious problems presented by New Jersey's position. *Amici* also are concerned about the use by domiciliary and non-domiciliary States of conflicting standards for characterizing income either as "business" or "non-business." At the very least, as discussed above, New Jersey's position constitutes a radical shift towards "business" income—assuming it does not destroy the concept of "non-business" income altogether, as *amici* contend. Domiciliary States can be expected to resist this shift and to rely on existing precedent to the maximum extent possible in continuing to treat income as non-business income.[17] This problem of a consistent

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[17] *Amicus* briefs filed to date in support of New Jersey assume that the concept of non-business income would remain intact. *See*, Brief *Amicus Curiae* of Multistate Tax Commission, p. 29; Brief of *Amicus Curiae* California, *et al.*, pp. 27-28.

definition of "business" and "non-business" income is exacerbated by New Jersey's attempt to bolster its position by invoking the concepts of "presumption" and "administrative convenience."[18] This approach would virtually guarantee double taxation by insuring different standards. Under New Jersey's approach, income would *presumptively* be apportionable as business income by non-domiciliary States. At the same time, domiciliary States could apply a different presumption or legal standard and impose a different burden of proof on taxpayers.

In view of this prospect for increased use of conflicting legal standards for defining "business" and "non-business" income, the Court should be prepared to affirm that, if New Jersey's definition of a business income were accepted and *ASARCO* and *Woolworth* were overruled, the same definition *must* be followed by all States. As indicated, *amici* believe this would radically shift traditional taxing prerogatives from domiciliary to non-domiciliary States. But, at least the prospect of double taxation would be minimized.

It is obvious why New Jersey would readily agree to a rule providing that all intangible income is apportionable and no portion may be allocated as non-business income to any State. New Jersey's statute apportions all income and does not allocate any non-business income to New Jersey. N.J.S.A. §54:10A-4(k); §54:10A-6. At the same time, however, 35 States allocate non-business or investment income. State Tax Guide, Vol. 1, ¶ 10-110 (CCH).

Nor is New Jersey bashful about the consequences of its infringement on the historic taxing jurisdiction of domici-

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[18] *See, e.g.*, Tr. 32 (see reference to the need for "237 interrogatories with subparts, 10 depositions, and a document request"); Tr. 34 (". . . but the problem is this line drawing, and how is the Court going to help this situation if every time to find out whether there's a unitary business we have to go through the process we went through here."); Tr. 38 ("You have to assume that [flows of value are] there. We can't delve into these facts in every one of these cases. It's an unworkable proposition."); Tr. 44 ("I think once you've decided that what is in the business is presumptively part of the unitary business Tennessee would have to apportion. Tennessee could not then grab it all.").

liary States. It recognizes the conflict. But, during oral argument, counsel for New Jersey asked why the domiciliary States should be preferred. (Tr. 40). The question misses the point. As this Court clarified in *Mobil*, 445 U.S. at 443-446, there is no preference insofar as the treatment of business income is concerned. But, under the Due Process and Commerce Clauses, non-domiciliary States may only tax income that is attributable to the taxpayer's in-state business activities. Ultimately, that is the constitutional standard that New Jersey must satisfy in taxing non-domiciliary corporations.

In sum, the Court should only overrule *ASARCO* and *Woolworth* if the Court also is willing to alter the historic relationship between domiciliary and non-domiciliary States in order to prevent duplicative taxation of intangible income. If the Court is unwilling to alter that relationship, then it should not overrule those cases since to do so would result in allocation and apportionment of the same income, a result the Court has stated is unacceptable.[19]

B. Duplicative Taxation of Business Income.

The considerations here are essentially the same. Again, counsel for New Jersey forthrightly acknowledged that, under the State's position, all activities of a single corporation would constitute a single unitary business so that no State could treat the profitable activities in its jurisdiction as a separate business fully taxable by that State. Thus, in response to a hypothetical question about a profitable forest business in Tennessee, counsel responded (Tr. 44):

> MS. HAMILL: I think once you've decided that what is in the business is presumptively part of

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[19] Finally, even if the State of commercial domicile agreed to treat the income as apportionable, there is *still* a prospect of double taxation if the States adopt inconsistent apportionment formulas. Understandably, if the corporation's investment activity were deemed to give rise to business income, the State of commercial domicile may want that fact reflected in some meaningful way in the formula. To date, as discussed *supra*, States like New Jersey have been unwilling to modify their formulas.

the unitary business Tennessee would have to apportion. Tennessee could not then grab it all.

Again, *amici* strongly object to New Jersey's radical position that all corporate activities are part of the same unitary business. But, if the Court adopts this position, it should also clarify that it is binding on all States.

CONCLUSION

The Court should not overrule *ASARCO* and *Woolworth*. If *ASARCO* and *Woolworth* were overruled, it will be even more important for the Court (1) to clarify that modification of the apportionment formula is required to reflect the inclusion of intangible income in the apportionable base, and (2) to clarify that all States are bound by the same unitary business test so that duplicative state taxation will be avoided.

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Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL, INC., as successor-in-interest to The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The Supreme Court of New Jersey

BRIEF FOR AMERICAN GENERAL CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

1. Should the Court overrule *ASARCO v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

TABLE OF CONTENTS

Page

INTEREST OF AMICUS 1

ARGUMENT 2

I. The Court Should Clarify Its Decisions in *ASARCO* and *Woolworth* to Treat Income Generated by an Intangible Asset as Apportionable Income if the Asset Constitutes an Integral Part of the Taxpayer's Unitary Business 2

A. Operational Control Should Not Be a Prerequisite to Apportionability 3

B. The *Mobil* Decision Reflects the Proper Way to Analyze Dividend and Capital Gain Income 5

II. The Court Should Reject Any Rule Treating All Income as Apportionable 6

A. Treating All Income as Apportionable Strains the Due Process Requirement of Fair Apportionment 7

B. The New Jersey Rule of Apportionability Would Compel Taxpayers to Adopt an Inefficient Form of Organization 10

C. When the New Jersey Rule of Apportionability Is Applied to Combined Reporting States, the Rule Apportions and Taxes the Nonbusiness Income of Corporations Not Engaged in Business in the Taxing State, Thereby Emasculating the Due Process Clause 10

III. If the Court Adopts the New Jersey Approach, the Court Must Also Rule That a Domiciliary State Cannot Tax All Unrelated Investment Income; These Changes Should Not Be Made Retroactively 13

CONCLUSION 14

TABLE OF AUTHORITIES

Page

CASES

ASARCO v. Idaho State Tax Commission, 458 U.S. 307 (1982) ..... *passim*

AT&T v. Wisconsin Dept. of Rev., 422 N.W.2d 629 (Wis. Ct. App. 1988) 12

Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983) ..... *passim*

Exxon Corp. v. Wisconsin Department of Revenue, 447 U.S. 207 (1980) 11

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NCR Corp. v. Commissioner of Revenue, 438 N.W.2d 86 (Minn. 1989) 12

NCR Corporation v. Wisconsin Department of Revenue, Docket Nos. I-8669 and 87-I-359, Wisconsin Tax Appeals Commission 12

NCR v. Comptroller, 544 A.2d 764 (Md. 1988) 12

Tambrands v. Maine State Tax Assessor, 595 A.2d 1039 (Me. 1991) 12

STATUTES AND REGULATIONS

Uniform Division of Income for Tax Purposes Act (UDITPA), 7A Uniform Laws Annotated 331 (1985) ..... *passim*

Multistate Tax Commission Regulation IV.1.(b) 8

TABLE OF AUTHORITIES – Continued

Page

OTHER

Roy E. Crawford and Russell D. Uzes, *The Distinction Between Business and Nonbusiness Income*, The State & Local Tax Portfolio Series 665-683 (Corporate Tax Publishers, Inc. 1991)..... *passim*

Jerome Hellerstein, 1 *State Taxation* ¶8.6 (1983)..... 7

INTEREST OF AMICUS

American General Corporation hereby respectfully files this Amicus Curiae Brief in Support of Petitioner Allied-Signal Inc. American General has received the consent of both parties to file the Amicus brief.

American General Corporation is the Texas-based parent of a large affiliated group of corporations. The affiliated group conducts an insurance business and a financial services and consumer lending business.

The decision in this case could have a profound influence on a current dispute between American General Corporation and the California Franchise Tax Board. During the early 1980's, several members of the American General affiliated group operated a mutual fund management business in California. American General Corporation, the mutual fund companies and other non-insurance corporations joined together and filed a single combined report each year in California (the "mutual fund combined report"), and paid a tax to California based on the amount of mutual fund income apportioned to California by a three-factor apportionment formula. California proposes to treat the dividends received by American General Corporation from its insurance subsidiaries, *which were not included in the mutual fund combined report*, as mutual fund apportionable income. California proposes to apportion the dividend income with reference to the apportionment factors of the mutual fund management business. American General is contesting this treatment.

This Brief addresses the questions raised by the Court in its March 11, 1992 Order from the perspective of a multi-state taxpayer that files returns in combined

reporting states such as California. The Brief proposes a rule of apportionability similar to the rule contained in the Uniform Division of Income for Tax Purposes Act (UDITPA), 7A Uniform Laws Annotated 331 (1985), and discusses why the Court should reject the standard of full apportionability advanced by Respondent (New Jersey) during oral argument.

ARGUMENT

The Court should adopt a rule of apportionability that would allow a state to tax income related to an intangible asset only if the asset constitutes an integral part of the taxpayer's unitary business. The Court should reject New Jersey's proposal to empower a state to apportion and tax the *entire* net income of a corporation. New Jersey's proposed standard would merely shift the due process inquiry to the more ephemeral issue of fair apportionment.

I. The Court Should Clarify Its Decisions in *ASARCO* and *Woolworth* to Treat Income Generated by an Intangible Asset as Apportionable Income if the Asset Constitutes an Integral Part of the Taxpayer's Unitary Business.

State courts and administrative tribunals have applied *ASARCO v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation and Revenue*

Department, 458 U.S. 354 (1982), inconsistently.[1] For the benefit of both taxpayers and taxing authorities, the Court should clarify its decisions in *ASARCO* and *Woolworth* to diminish the importance of operational control and adopt a standard of apportionability similar to the standard in UDITPA.

A. Operational Control Should Not Be a Prerequisite to Apportionability.

The concept of a unitary business relationship arises in two distinct contexts. The first is whether an item of income is sufficiently related to the business conducted in a state by a corporation to permit a state to tax that income. *See, e.g., Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). The second is whether the business conducted by a corporation is part of a single or unitary business conducted by other corporations so that a state may apportion the combined income of the group. *See, e.g., Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

The Court in *ASARCO* blurred this distinction. The parties in *ASARCO* disputed whether a minimal connection existed between ASARCO's dividend income and ASARCO's activities in Idaho. In resolving this dispute, the Court focused on ASARCO's lack of operational control over its foreign affiliates. The existence of operational control is only significant, however, for purposes of

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[1] *See* Roy E. Crawford and Russell D. Uzes, *The Distinction Between Business and Nonbusiness Income*, The State & Local Tax Portfolio Series 665-683 (Corporate Tax Publishers, Inc. 1991).

determining whether two or more corporations are engaged in a unitary business and should file a combined report in a combined reporting state.[2]

There is no reason why operational control over an affiliate should determine whether an item of income is sufficiently connected to the activities of the taxpayer in the taxing state. The Court in *Mobil* recognized that an intangible asset such as a minority stock interest in an affiliate can advance the unitary business of the owner.[3] For a vertically integrated business, a minority-owned affiliate can provide an important source of supply for the owner or an assured market for the owner's product. For a horizontally owned business, an affiliate can serve as a toehold into a new geographic market for the investor, with the investor benefitting from new information and access to untapped markets.

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[2] Only commonly owned and controlled corporations file a combined report because a combined report can change the tax liability of each corporation included in the report in a dramatic fashion. In a combined report, each member engaged in business in the state is attributed a share of the combined income. Thus, a member with a loss on a separate return basis may actually be attributed positive taxable income if the overall combined group is profitable. A sense of fairness limits the application of combined reports, therefore, to commonly owned and controlled corporations.

[3] The Court was clearly correct in *Mobil* when it held that Vermont could tax the dividend income Mobil received from affiliates like the 10%-owned Aramco. Mobil undoubtedly participated in Aramco because Aramco advanced Mobil's unitary petroleum business substantially. Mobil did not have operational control over Aramco, however, with only a 10% ownership interest.

B. The *Mobil* Decision Reflects the Proper Way to Analyze Dividend and Capital Gain Income.

The Court in *Mobil* stated that the "linchpin of apportionability in the field of state income taxation is the unitary business principle." 445 U.S. at 439. All assets constituting an integral part of the taxpayer's unitary business should generate apportionable income.[4] The Court implicitly applied this standard in *Mobil* when it characterized the dividends received by Mobil from its 10% stock interest in Aramco as apportionable income.[5]

This standard requires a review of the operational ties between the taxpayer and the minority-owned affiliate. A taxpayer's unitary business can benefit from the affiliate in an operational manner in many ways, including intercompany transactions, shared technology, personnel transfers, and joint purchases and sales. These operational relationships indicate that a "flow of value" exists between the taxpayer and the affiliate. *Container*, 463 U.S. at 176. Importantly, taxpayers and taxing authorities can identify these relationships using objective manifestations. The Court should revise the *ASARCO* and

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[4] This standard is consistent with the UDITPA definition of business income, which is defined as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." UDITPA § 1(a), 7A Uniform Laws Annotated at 336.

[5] The dissenting opinion in *ASARCO* suggests this standard in Part II.C. *ASARCO*, 458 U.S. at 340 (O'Connor, J., dissenting).

Woolworth decisions to clarify that due process standards are met only when an item of income has an operational, unitary relationship with the activity conducted by a taxpayer engaged in business in a taxing state.[6]

II. The Court Should Reject Any Rule Treating All Income as Apportionable.

During oral argument New Jersey asserted that all of the income of a single corporation should be treated as apportionable income. The New Jersey rule of apportionability runs afoul of the Court's decision in *Mobil*, where the Court determined that a state can only tax an item of income under the Due Process Clause if the income is related to the business activities of the taxpayer in the taxing state. *Mobil*, 445 U.S. at 437. In addition, adopting New Jersey's approach would create a number of significant problems.

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[6] The dissenting opinion in *ASARCO* suggests that dividend income should be apportionable even in the absence of an operational relationship between the dividend payor and recipient. 458 U.S. at 335 (Part II.A of the dissent) and 337 (Part II.B of the dissent). Other than in the working capital context, the standard of apportionability should depend on the existence of operational ties. Any lesser standard becomes nebulous and difficult to prove, and therefore leads to recurring disputes.

A. Treating All Income as Apportionable Strains the Due Process Requirement of Fair Apportionment.

Overruling *ASARCO, Woolworth* and *Mobil* would not end due process disputes in state taxation. The Due Process Clause requires a rational relationship between the income attributed to a state and the intrastate values of the corporation, or fair apportionment. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978). The factors used in the apportionment formula must reflect in a reasonable sense how the taxpayer generated income. *Container*, 463 U.S. at 169. The New Jersey rule of apportionability would merely shift the constitutional dispute from the apportionability of an item of income to fair apportionment.[7]

If all income is apportionable, taxpayers and taxing authorities will dispute whether the amount of nonbusiness income (such as unrelated investment income) apportioned to a state bears a rational relationship to the intrastate values of the corporation. A brief review of the current apportionment schemes employed by the states will illustrate the problem.

The most common apportionment formula, the three-factor formula, was designed to apportion the income of manufacturing and merchandising businesses. *See* Jerome

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[7] The apportionability of income cases typically involve whether a state has jurisdiction to tax an item of income earned by a taxpayer not domiciled in the taxing state. *See, e.g., ASARCO* and *Mobil, supra*. Fair apportionment cases typically involve an apportionment formula that arguably attributes too much income to the taxing state. *See, e.g., Moorman, supra*.

Hellerstein, 1 *State Taxation* ¶8.6 (1983). The formula was not designed to apportion nonbusiness income, because that income was typically allocated in whole to the state of domicile.[8] For these reasons, the standard three-factor formula is ill-equipped to handle adequately the apportioning of nonbusiness income.

UDITPA recognizes that fair apportionment is made more difficult when a corporation conducts multiple diverse businesses (as opposed to a single unitary business). UDITPA establishes separate pools of income for apportionment purposes when a corporation or an affiliated group engages in multiple diverse businesses.[9] UDITPA also establishes separate pools of income when a taxpayer engages in a financial and a merchandising business because the income-producing characteristics of these two activities vary significantly.[10] The New Jersey

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[8] *See* R. Crawford and R. Uzes, *supra*, at ¶505. The UDITPA model apportions income by way of the three-factor formula and allocates investment income to a particular situs state.

[9] *See* Multistate Tax Commission Regulation IV.1.(b) (Two or More Businesses of a Single Taxpayer). The Multistate Tax Commission adopts uniform regulations interpreting UDITPA under the authority of Article VII of the Multistate Tax Compact.

[10] *See* UDITPA § 2, 7A Uniform Laws Annotated at 340.

approach of full apportionment is limited conceptually, however, to a single apportionment formula.[11] The New Jersey approach reaches irrational results, therefore, in instances in which a single apportionment formula is inadequate under UDITPA.

Separate return states that do not employ the three-factor formula will encounter even more difficult fair apportionment problems. The Iowa single-receipts factor approved by this Court in *Moorman* would likely result in *per se* violations of the Due Process Clause if used to apportion nonbusiness income. No rational relationship would exist between the nonbusiness income attributed to the state and the market provided by the state for the taxpayer's products.

Requiring a minimum connection between an item of income and the taxpayer's activities within the taxing state prevents the fair apportionment problems discussed above. As illustrated by the *Moorman* case, sound policy reasons support retention of the standard of apportionability articulated by the Court in the *Mobil* decision.

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[11] A multiple apportionment formula system attempts to measure the contribution a state makes to each diverse business activity engaged in by a taxpayer. If the state does not make a contribution to one of the business activities (the apportionment formula is zero), the state does not tax any of the income related to that business. Under the New Jersey approach, however, New Jersey apportions all of the income of a taxpayer with one apportionment formula without reference to the location of any given business. New Jersey simply defines all activities of a corporation as a single unitary business. (Tr. at 31.)

B. The New Jersey Rule of Apportionability Would Compel Taxpayers to Adopt an Inefficient Form of Organization.

The New Jersey approach compels taxpayers to adopt a multicorporate form. To limit the reach of New Jersey and other separate return states, taxpayers will place investments and non-nexus businesses in corporations having no contact with the separate return states. New Jersey's approach would therefore create a shell game involving corporate entities.[12]

C. When the New Jersey Rule of Apportionability Is Applied to Combined Reporting States, the Rule Apportions and Taxes the Nonbusiness Income of Corporations Not Engaged in Business in the Taxing State, Thereby Emasculating the Due Process Clause.

California, like many other states that have adopted UDITPA, requires affiliated corporations engaged in a unitary business to file a combined report. A combined report typically includes the income and apportionment factors of all unitary group members regardless of where they do business. The combined report allocates all nonbusiness investment income generally to the state of commercial domicile of the recipient corporation. The combined report creates separate pools of income for each unitary business; a corporation may be included in more than one pool of income subject to apportionment.

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[12] For example, Bendix could have avoided the New Jersey tax completely if it had a holding company structure, with one subsidiary operating the business of Bendix and another subsidiary holding the ASARCO investment.

The California income of a unitary group is the amount of combined net income apportioned to California by the combined apportionment formula. California income is then reattributed to and split among those unitary members who are engaged in business in California. Each corporation receiving income through this reattribution process becomes liable separately for the tax on its share of apportioned income. Each corporation will also pay tax on its items of nonbusiness income allocable to California.

The New Jersey approach emasculates the Due Process Clause if the approach allows a combined reporting state to apportion and tax the nonbusiness income of all of the corporations in the unitary group, including the nonbusiness income of corporations not engaged in business in the taxing state. This result contradicts every significant unitary tax case, including *Mobil*, *ASARCO*, *Woolworth*, *Container* and *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980).[13]

Similar to the argument made by New Jersey during oral argument, the combined reporting states that seek to tax the nonbusiness income of non-nexus corporations will likely claim that any unfairness can be remedied through an apportionment formula adjustment. But, in practice, taxpayers find *ad hoc* modifications to apportionment formulas difficult if not impossible to make.

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[13] States may be compelled to discard the unitary business principle entirely, which would mean that the only options would be either separate returns or a consolidated return concept involving all affiliated (including nonunitary) members.

American General's situation in California illustrates the problem. If the New Jersey approach applied to combined reporting states like California, California would apportion the significant insurance company dividends received by American General Corporation using the apportionment formula of the relatively small mutual fund management business. It would be difficult to fashion an apportionment formula adjustment because there is no rational relationship between the dividends paid out of the earnings and profits of the insurance companies and the California activities of the mutual fund business. Including the insurance companies in the mutual fund combined report would be one option, but a difficult one because California, like other states, taxes insurance companies on gross premiums in lieu of a tax on income. The other options are equally complicated, especially given the size of the American General affiliated group. State courts have struggled greatly and reached different conclusions in similar and less complicated cases.[14]

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[14] *See Tambrands v. Maine State Tax Assessor*, 595 A.2d 1039 (Me. 1991); *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989); *NCR v. Comptroller*, 544 A.2d 764 (Md. 1988); *AT&T v. Wisconsin Dept. of Rev.*, 422 N.W.2d 629 (Wis. Ct. App. 1988); and *NCR Corporation v. Wisconsin Department of Revenue*, Docket Nos. I-8669 and 87-I-359, Wisconsin Tax Appeals Commission.

III. If the Court Adopts the New Jersey Approach, the Court Must Also Rule That a Domiciliary State Cannot Tax All Unrelated Investment Income; These Changes Should Not Be Made Retroactively.

To adopt the New Jersey approach in this case, the Court will also have to determine that the state of commercial domicile can only tax an apportioned share of a taxpayer's investment income. The Court would create chaos for taxpayers and taxing authorities alike if it failed to decide this issue. Taxpayers would face double taxation, and the states would find it impossible to predict revenues accurately given the prospect of retroactive refunds.

A standard of full apportionability can only be imposed fairly on a prospective basis. A retroactive change would create purely random, unanticipated results for both taxpayers and states, especially since statutes of limitations are not consistent from state to state and taxpayers likely have waivers or extensions in place in some states but not others. If the Court reverses *ASARCO* and *Woolworth* but reaffirms the unitary business principle as suggested above, the need for prospective application is less pressing but still necessary to avoid creating difficulties for taxpayers and taxing authorities in those states that have adhered to a literal interpretation of *ASARCO* and *Woolworth*.

CONCLUSION

For the reasons discussed above, the Court should adopt a rule of apportionability that would allow a state to tax income related to an intangible asset only if the asset constitutes an integral part of the taxpayer's unitary business. The Court should reject New Jersey's proposal to empower a state to apportion and tax the entire net income of a corporation.

April 1992

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Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF FOR BEATRICE COMPANY, THE COCA-COLA COMPANY, FORD MOTOR COMPANY, INTERNATIONAL BUSINESS MACHINES CORPORATION, INTERNATIONAL PAPER COMPANY, LOEWS CORPORATION, MOBIL OIL CORPORATION, AND W. R. GRACE & CO. AS AMICI CURIAE IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

	Page
INTEREST OF THE AMICI CURIAE	1
SUMMARY OF ARGUMENT	2
ARGUMENT	6
I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED	6
A. *ASARCO* and *Woolworth* Are Solidly Grounded in Long-Established Principles of State Tax Jurisprudence	6
1. The Unitary Business Principle Derives from Due Process and Commerce Clause Prohibitions Against Extraterritorial Taxation	7
2. The Court's Treatment of Intangible Income in *Mobil*, *ASARCO*, and *Woolworth* Follows Inexorably from the Unitary Business Principle	9
B. Abandoning the Unitary Business Principle Would Pose Significant Constitutional and Practical Difficulties	11
1. Apportionment of Intangible Income from Non-Unitary Investment Would Require Wholesale Revisions and Judicial Reassessments of State Apportionment Formulas	12
2. Rejecting *ASARCO* and *Woolworth*'s Treatment of Intangible Income Necessarily Comprehends Rejecting Unitary Taxation Principles for Operational Income as Well	14
3. Abandoning Unitary Taxation Will Create Obstacles to a State's Ability to Tax Income Earned Within Its Borders	17

TABLE OF CONTENTS—Continued

Page

4. Any Significant Departure from the Unitary Business Principle Should Come from Congress, Not from This Court 22

II. A DECISION OVERRULING *ASARCO* AND *WOOLWORTH* SHOULD APPLY ONLY PROSPECTIVELY 27

CONCLUSION 30

TABLE OF AUTHORITIES

CASES — Page

ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) ..... *passim*
Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 9, 15
American Trucking Ass'ns v. Smith, 110 S. Ct. 2323 (1990) 27, 28
Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) 7
Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) 8
Braniff Airways, Inc. v. Nebraska State Bd. of Equalization & Assessment, 347 U.S. 590 (1954) 17
Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573 (1986) 7
Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932) 23
Butler Bros. v. McColgan, 315 U.S. 501 (1942) 8, 15
Central Railroad Co. v. Pennsylvania, 370 U.S. 607 (1962) 17, 24
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 5, 27, 28
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) ..... *passim*
Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980) 8, 14, 16
F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982) ..... *passim*
James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991) 27, 29
Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) 18, 20
M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) 26
McCarroll v. Dixie Greyhound Lines, Inc., 309 U.S. 176 (1940) 23
McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 110 S. Ct. 2238 (1990) 28
Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869 (1985) 25

TABLE OF AUTHORITIES—Continued

	Page
Milwaukee County Pavers Ass'n v. Fiedler, 922 F.2d 419 (7th Cir.), *cert. denied*, 111 S. Ct. 2261 (1991)	26
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)	*passim*
Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978)	13
National Bank v. Whitney, 103 U.S. 99 (1880)	23
Northwest Airlines, Inc. v. Minnesota, 322 U.S. 292 (1944)	23
Payne v. Tennessee, 111 S. Ct. 2597 (1991)	22
Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946)	5, 25, 26
Standard Oil Co. v. Peck, 342 U.S. 382 (1952)	4, 17
State Railroad Tax Cases, 92 U.S. 575 (1875)	8
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920)	8
Union Refrigerator Transit Co. v. Kentucky, 199 U.S. 194 (1905)	24
United States v. Goodyear Tire & Rubber Co., 110 S. Ct. 462 (1989)	15
Wallace v. Hines, 253 U.S. 66 (1920)	9
Walters v. National Ass'n of Radiation Survivors, 473 U.S. 305, 318-19 (1985)	26
Western & Southern Life Ins. Co. v. State Board of Equalization, 451 U.S. 648 (1981)	24
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)	7

STATUTES

McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015	25
N.J. Stat. Ann. §§ 54:10A-4(k), 54:10A-5(c)	16
Uniform Division of Income Tax Purposes Act, 7A U.L.A. 331 (1985)	9, 12

MISCELLANEOUS

Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387 (1983)	25, 26
Developments in the Law—Federal Limitations on State Taxation of Interstate Business, 75 Harv. L. Rev. 953 (1962)	9

TABLE OF AUTHORITIES—Continued

Page

Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993 (1986) 25

J. Hellerstein & W. Hellerstein, *State and Local Taxation* (4th ed. 1978) 9

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INTEREST OF THE AMICI CURIAE

The amici curiae are multijurisdictional corporations that do business in, and are subject to taxation by, many states. Each receives various forms of investment income derived from its ownership of intangible property—including income from dividends, royalties, interest, and

capital gains. The amici therefore have a strong interest in the constitutional principles governing state taxation of intangible and other forms of income earned by multistate businesses. A decision overruling *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 344 (1982), would substantially alter those principles and would significantly affect both the tax liabilities of the amici and the environment in which they conduct their business.

Counsel for the parties have consented to the filing of this brief in letters filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

I. A. *ASARCO* and *Woolworth* are an integral part of a longstanding and coherent constitutional structure for the taxation of multistate corporations. A state may tax income only to the extent that it provides benefits and protection to the activities that generate the income. For a functionally integrated enterprise operating in different jurisdictions, states comport with that basic territorial limitation by accumulating all the income of the enterprise and taxing an apportioned share fairly reflecting the enterprise's in-state activities. But where a company earns income through a non-unitary "discrete business enterprise," a state that has no connection with the activities of that separate enterprise has no authority to tax the income it generates; its connection with the company alone is not enough. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439-40 (1980). This "unitary-business principle" is the "linchpin" of the apportionment system. *Id.* at 439.

Mobil, *ASARCO*, and *Woolworth* faithfully apply the unitary business principle to the taxation of intangible income. Dividends are apportionable only if the payor's income-earning activities outside the state are integrally related to the recipient's business activities inside the

state. Overruling these cases would create major dislocations in settled law and yield an inferior system fraught with difficulties.

B. 1. Including in the apportionable base intangible income arising from non-unitary economic activity would add vast sums that bear no relation to the traditional operational apportionment factors—payroll, property, and sales. Fair apportionment of such non-operational income would require major readjustment of existing formulas. States would likely adopt conflicting approaches tailored to maximize their own tax revenues from out-of-state taxpayers, with the practical consequence that multistate businesses, unlike purely local businesses, would be subject to taxation on more than 100% of their income. While the Court has said that the Commerce Clause tolerates *some* risk of multiple taxation from differing state apportionment formulas, the risk may be greatly magnified if significant new sums of passive intangible income are added to the apportionable base. At a minimum, the courts are likely to become embroiled in constitutional evaluation of redesigned apportionment formulas.

2. Abandoning the unitary business principle for intangible income necessarily entails jettisoning that principle for ordinary operational income as well. Under present law, where a company conducts two discrete businesses in different states through unincorporated divisions, each state can tax only the business with which it has a connection. But that rule is untenable if a state can tax dividend income received from a non-unitary subsidiary, because that would create a senseless distinction based on corporate form that has nothing to do with the rationale for the state's exercise of its taxing power. Thus, the logical consequence of New Jersey's argument is completely to eliminate the "linchpin" unitary business principle from the state taxation structure.

3. Overruling *ASARCO* and *Woolworth* would have the effect of substantially restricting state taxing au-

tonomy. Because of Commerce Clause constraints, *permitting* states to tax a company's income earned from its discrete, non-unitary operations requires *prohibiting* other states from fully taxing those discrete enterprises that operate within their borders. Two incompatible theories of taxation cannot coexist when one allows a state to tax income in full while the other permits a different state to tax an apportioned share of the same income. That situation would inevitably yield multiple taxation in violation of the Commerce Clause. *See Mobil*, 445 U.S. at 445-46; *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952).

This principle is fully applicable here. If New Jersey can invoke a common ownership theory to tax an apportioned share of the income from a business that operates discrete divisions in other states, without regard to whether the underlying economic activities are functionally related, it follows that other states will have to tax under the same theory as New Jersey. They would no longer be free to tax a discrete business by itself, but would have to limit themselves to an apportioned share of its income, taking into account other non-unitary businesses under common ownership. This change in the law would directly harm states in which relatively profitable discrete businesses operate. It would also reduce the rationality of the system by drawing tax revenues away from the states where the value being taxed was earned.

4. Considerations of *stare decisis* militate strongly against overruling *ASARCO* and *Woolworth*. Companies have organized their affairs, and states have drafted their statutes, with heavy reliance on the existing unitary business framework. Abandoning that principle would require legislatures in dozens of states to reconfigure their schemes for taxing the income of multistate taxpayers. Even if some change is needed, Congress's ability to study problems and fine-tune solutions makes it far better equipped than the judiciary to tackle the essentially legislative task of constructing a new system of multistate

taxation. To the extent the nexus limitations imposed by current law rest on the Commerce Clause, it is clear that Congress can intervene. Even if those restrictions are an element of due process, Congress may well have authority to legislate because Fourteenth Amendment territorial limitations apply only to the states and are not "designed to forbid action altogether by any power or combination of powers in our governmental system." *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 434-35 (1946).

II. If the Court were to overrule *ASARCO* and *Woolworth*, this would be a powerful case for prospectivity under the traditional analysis of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). The change in the law would overturn settled expectations, and retroactive effect would thwart, not promote, underlying constitutional policies. Retroactivity would also create a substantial risk of multiple taxation. Companies suddenly subjected to new taxation of intangible income on an apportioned basis might be unable, because of differing statutes of limitation, to obtain a refund from a state that had fully taxed that income on an allocation theory. The converse situation could unfairly harm states.

ARGUMENT

I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED

A. *ASARCO* and *Woolworth* Are Solidly Grounded in Long-Established Principles of State Tax Jurisprudence

In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), this Court distilled from numerous prior decisions a straightforward principle now considered axiomatic: "the linchpin of apportionability in the field of state income taxation is the unitary-business principle." The Court there permitted a non-domiciliary state to tax an apportioned share of Mobil's dividend income because the payor's out-of-state activities were integrally related to Mobil's in-state activities. The Court recognized, however, that the result might be different "[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, . . . because there would be no underlying unitary business." *Id.* at 442. That was the situation in *ASARCO* and *Woolworth*, where the Court held, true to its statement in *Mobil*, that a non-domiciliary state may not apportion dividends, interest, and capital gains income from investments in non-unitary subsidiaries.

New Jersey has now invited the Court to repudiate the previously settled unitary business principle, to overrule *ASARCO* and *Woolworth*, and to substitute a rule under which a state may tax an apportioned share of all income (or at least all investment income) regardless of whether the economic activities generating that income have any connection at all to the taxpayer's in-state business activities. But the unitary business principle derives inexorably from fundamental constitutional limitations on state taxing power and cannot casually be tossed aside. Abandoning that principle would require dismantling decades of this Court's state tax jurisprudence, drastically reallocating state tax revenues, and disturbing the settled ex-

pectations on which multistate businesses have long relied in structuring themselves.

1. *The Unitary Business Principle Derives from Due Process and Commerce Clause Prohibitions Against Extraterritorial Taxation*

The unitary business principle's analytical wellspring is this fundamental precept: "Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.' " *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) (quoting *ASARCO*, 458 U.S. at 315). A state is entitled to tax only to the extent that it provides "protection, opportunity and benefits . . . for which it can ask return." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). Income generated by out-of-state economic activities, if unconnected to any in-state activities, has no relationship to the benefits provided by the state and therefore lies beyond its permissible reach.

The rule is not unique to state taxing authority. The Court has long held under the Commerce Clause that a state "has no power to project its legislation into" other states by effectively regulating conduct that occurs there. *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935) (milk price regulation). A statute with such "extraterritorial effects," even if "addressed" only to in-state conduct, is invalid if "the 'practical effect' of the law is to control [conduct] in other States." *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573, 580-83 (1986) (liquor price affirmation statute).

While a state cannot lawfully control what is *outside* its borders, it has ample authority to tax or regulate what is *inside* its borders. And when something is partly within and partly without, the state naturally has room to determine reasonably the portion properly within its jurisdictional reach. Thus, in the context of income taxa-

tion, where a functionally integrated enterprise conducts its income-generating activities in several different jurisdictions, a state may calculate the "locally taxable income" by the apportionment method—accumulating the income of the multistate enterprise and apportioning to itself a share of the total based on a fair assessment of the state's relative contribution to the enterprise's success. *Container*, 463 U.S. at 164, 165. Because "[t]he net income of an organic, unitary business . . . is indivisible" (*ASARCO*, 458 U.S. at 333 n.1 (O'Connor, J., dissenting)), apportionment is considered a more accurate mechanism than separate geographical accounting for determining where the income of the business is truly earned and therefore the extent to which various states contribute to the income. *See, e.g., Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 218 (1980); *Butler Bros. v. McColgan*, 315 U.S. 501, 506-09 (1942); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924).

This unitary business principle, however, permits a state to include in the apportionable tax base income from out-of-state activities only if those activities have contributed—either operationally or through the creation of economies of scale or similar economic benefits—to "a unitary stream of income." *Exxon*, 447 U.S. at 226. Where the in-state and out-of-state activities are "discrete business enterprise[s]" (*Mobil*, 445 U.S. at 439), the rationale for formula apportionment breaks down because the income does not make a logically indivisible contribution to the profitability of a single business. The out-of-state income is not relevant to determining "the net profits earned within the State." *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120 (1920).

This fundamental distinction has its source in the century-old "unit rule" for apportioning state property, capital stock, and other taxes imposed on interstate railroads, express and telegraph companies, and similar enterprises. *See, e.g., State Railroad Tax Cases*, 92 U.S. 575, 608 (1875). The rule provides that, where a "unity

of use and management" connects the multistate activities of an enterprise, it may be taxed as a unit—even when "it may not be a physical unity." *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 222 (1897). But it has always been clear that "something more than a mere unity of ownership" is required in order to justify apportionment. *Id.* Out-of-state income is includable in the apportionment base only where it "can be seen in some plain and fairly intelligible way that it adds to the value of the [property] and the rights exercised in the State"; otherwise, apportionment would "open to taxation what is not within the State." *Wallace v. Hines*, 253 U.S. 66, 69 (1920).

2. *The Court's Treatment of Intangible Income in* Mobil, ASARCO, *and* Woolworth *Follows Inexorably from the Unitary Business Principle*

States have long used apportionment methods to tax multistate *business* income. But most *non-business* income, "such as rentals and capital gains from real and tangible personal property, dividends and interest from investments, royalties from patents or copyrights, and income from personal services," traditionally has been "thought to be specifically allocable to a particular activity rather than to grow out of the general business of the taxpayer." *Developments in the Law—Federal Limitations on State Taxation of Interstate Business*, 75 Harv. L. Rev. 953, 1010-11 (1962). Non-business income therefore has been taxed by allocating it to a particular jurisdiction. *Id.* For example, income from rents and royalties is allocated to the state where the underlying property is situated. *See* J. Hellerstein & W. Hellerstein, *State and Local Taxation* 399, 490-91 (4th ed. 1978). Income from intangible property is allocated to the taxpayer's commercial domicile (*e.g.*, interest and dividend income) or to the state in which the intangible is used (*e.g.*, income from patents and copyrights). *See* Uniform Division of Income for Tax Purposes Act ("UDITPA") §§ 7, 8, 7A U.L.A. 331 (1985).

In *Mobil*, the Court held that the traditional allocation approach to intangible income must bend in the face of the unitary business principle. The Court explained that, "so long as the intrastate and extrastate activities" that gave rise to the income "formed part of a single unitary business," there was no justification for excepting dividend income from the "general principle of apportionability" applicable to operating income. 445 U.S. at 437, 438. The Court emphasized, however, that "[o]ne must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." *Id.* at 440. Thus, the inquiry is whether the "operations of [the taxpayer's] subsidiaries and affiliates are distinct in any business or economic sense from its [business] activities in [the taxing state]" or whether the "dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise." *Id.* at 439, 440.

In *ASARCO* and *Woolworth*, the Court applied the legal principles synthesized in *Mobil* but ruled that the facts did not demonstrate a unitary business. 458 U.S. at 319. In *ASARCO*, the Court concluded that one of the dividend payors was "insufficiently connected" to the taxpayer's in-state activities and that the other dividend payors were "operate[d] entirely independently of" the taxpayer. *Id.* at 322, 323. In *Woolworth*, the Court found that "there [was] little or no integration of the business activities or centralization of management" linking the out-of-state subsidiaries with the taxpayer. 458 U.S. at 369.

While there is room to debate the Court's application of the legal principles to the facts of those cases, the legal principles themselves are rooted in the traditional unitary business concept. Indeed, the taxing states in those cases, like New Jersey here, had to acknowledge that they could not prevail unless the Court agreed to "expand the concept" so that "corporate *purpose*" or the economic bene-

fit of common ownership alone would justify apportionment. 458 U.S. at 325, 326 (emphasis in original); 458 U.S. at 363. But that approach, as the Court rightfully recognized, would tear the unitary business principle from its moorings in the prohibition against extraterritorial taxation. As the Court subsequently reiterated in *Container*, the essential focus remains on the extent to which the underlying income-generating activities are connected with the business conducted in the taxing state; the "mere flow of funds arising out of a passive investment or a distinct business operation" is insufficient to make "formula apportionment a reasonable method of taxation." 463 U.S. at 166.

B. Abandoning the Unitary Business Principle Would Pose Significant Constitutional and Practical Difficulties

In an area of the law where business planning puts a premium on certainty, the principles underlying *ASARCO* and *Woolworth* have become part of the legal landscape within which multistate corporations and state taxing authorities operate. With UDITPA providing guidance, the unitary business principle is now woven into the fabric of state tax statutes; abandoning that principle will require almost every state to take legislative action to revamp its tax laws. The present structure has proven to be workable, and it should be retained unless there exists a clearly superior substitute. That is not the case. Indeed, the proposal for replacing *ASARCO* and *Woolworth* is demonstrably *inferior*. It would raise a host of new issues for litigation and would ultimately create intractable difficulties in achieving a fair and rational system for taxation of multistate corporations.

1. *Apportionment of Intangible Income from Non-Unitary Investment Would Require Wholesale Revisions and Judicial Reassessments of State Apportionment Formulas*

To pass constitutional muster, "the factor or factors used in [an] apportionment formula must actually reflect a reasonable sense of how income is generated." *Container*, 463 U.S. at 168. Most states, including New Jersey, apportion income in accordance with the familiar three-factor formula, representing the unitary business's in-state ratios of payroll, property, and sales. That apportionment mechanism has been approved because "payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." *Id.* at 183.

The three-factor formula and its variations, however, reflect *operational* activities of a business and are designed to apportion *operational* income. That is so because the apportionable income base traditionally has been composed of income arising from transactions and activities conducted in the regular course of an active trade or business. *See, e.g.*, UDITPA §§ 1(a), (4). If the apportionable income base were significantly expanded to include large amounts of passive investment income from a taxpayer's holdings in discrete business enterprises, the traditional apportionment formulas would require concomitant adjustments to reflect reasonably the way such *non*-operational intangible income is generated. As Justice Stevens observed in his dissenting opinion in *Mobil*, "it is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income." 445 U.S. at 459. *See also Container*, 463 U.S. at 168 n.5.

Permitting apportionment of non-unitary passive investment income will therefore impose on states the obli-

gation to restructure their existing formulas. There is every reason to anticipate that they will adopt a crazy-quilt of conflicting solutions because there is no generally accepted method for apportioning such diverse kinds of intangible income as dividends, capital gains, and interest. The differences that emerge will not be random; rather, they may well arise from conscious decisions by individual states to maximize their own revenues from out-of-state taxpayers. The practical consequence is that companies operating in several states, unlike companies operating exclusively within one state, will be exposed to taxation on more than 100% of their income.

In approving Iowa's use of a single-factor sales formula to apportion operational income, the Court determined that the Commerce Clause tolerates, as the price of federalism, "some risk of duplicative taxation" occasioned by inconsistent apportionment mechanisms. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278 (1978). But if states are allowed to include in the apportionable tax base intangible income received from a non-unitary source, that risk will be greatly magnified—both because the fresh proliferation of more complex apportionment formulas will increase inconsistencies and because much more income will be funneled into the apportionable base. At some point, the multiple taxation that would inevitably result would so seriously threaten core Commerce Clause values—by imposing on interstate businesses duplicative tax liabilities from which intrastate enterprises are immune—that the limits of constitutional tolerance would surely be tested. At a minimum, the courts would almost certainly become embroiled in a whole new species of state tax litigation addressing the reformulated apportionment mechanisms and perhaps calling for heightened scrutiny of differing formulas to minimize the resulting interference with free interstate trade.

2. *Rejecting* ASARCO *and* Woolworth's *Treatment of Intangible Income Necessarily Comprehends Rejecting Unitary Taxation Principles for Operational Income As Well*

The problems with New Jersey's position go well beyond the difficulties it would pose in dealing with intangible income. This is so because the logical consequence of jettisoning the unitary/non-unitary distinction for intangible income is similarly abandoning the distinction for ordinary operational income. Otherwise, the taxing power of states over income generated by out-of-state economic activity, and the attendant division of tax revenues among the states, will vary substantially, but irrationally, depending on the corporate form chosen by the parent.

This problem is best illustrated by way of a simple example, similar to the one considered by the Court at oral argument in this case. Suppose a company, resident in Delaware, operates a beauty parlor business in New Jersey. It also operates a parking lot business in California. The latter is a "discrete business enterprise" (*Exxon*, 447 U.S. at 224; *Mobil*, 445 U.S. at 439) having nothing to do with the activities of the beauty parlor business.

If the businesses were structured as a parent corporation directly operating beauty parlors and also owning a California parking lot subsidiary, income from the parking lots would flow to the parent in the form of dividends. Contrary to *ASARCO*, New Jersey argues that it should be accorded the right to tax an apportioned share of those dividends as intangible income to the parent, with whom New Jersey has nexus because of the parent's beauty parlor business.

If we suppose instead that the businesses operate not through separate corporations, but rather through two divisions of the single corporation headquartered in Delaware, there would be no dividends or other intangible income. The parking lot business would earn the same income, but it would flow directly into the coffers of the

single corporation. Could New Jersey tax an apportioned share of that income?

The answer under current law is clearly no. That was precisely the issue presented in *Exxon*. The Court rejected Exxon's contention that its functional departments were "discrete business enterprises," concluding instead that they were all part of one "unitary business." 447 U.S. at 224. Based on that conclusion, it upheld Wisconsin's right to tax income from departments that did not do business in the state. But the case obviously began with the agreed legal premise that Wisconsin could *not* tax such income if the departments were not part of Exxon's unitary business. Otherwise, it would have been unnecessary to make the factual inquiry into unitariness. *See also, e.g., Butler Bros. v. McColgan*, 315 U.S. 501, 506-09 (1942); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 222 (1897).

But this settled result cannot logically coexist with New Jersey's proposed overruling of *ASARCO*. It is irrational for New Jersey's power to tax income from the parking lot business to vary depending upon whether the company operates the business through a division or a separate corporate entity that pays dividends. *See United States v. Goodyear Tire & Rubber Co.*, 110 S. Ct. 462, 467-68 (1989) (foreign tax credit rules tailored to eliminate unnecessary differences in tax treatment that depend on whether company operates through subsidiary or division). In either case, the economic activity that generates the income is the same. And the difference in corporate form has no apparent relationship to any justification for the exercise of the state's taxing jurisdiction.

In the state tax context involved here, this Court has already definitively rejected such a distinction in treatment based on corporate form. The Court observed in *Mobil* that "[o]ne must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." 445 U.S. at 440. Whether

run directly or through a subsidiary, the underlying activity is operating parking lots in California, and New Jersey's power to apportion income from that business should be the same in both cases. The Court held to that effect in *Mobil*: "Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives." 445 U.S. at 441.

This principle is equally applicable when the economic realities are that the business in question is non-unitary. If New Jersey's connection to the parent corporation gives it the power to tax non-unitary parking lot income when returned to a parent as a dividend, New Jersey should be able to tax the same parking lot income when it is earned directly by the parent. There is surely no constitutional justification for drawing any distinction. The nexus relied upon by New Jersey is the same in both instances—namely, the fact that the beauty parlor business operates in New Jersey.

In sum, New Jersey's argument that it can tax all intangible income of a company that does business there, whatever the source of the income, necessarily extends to the company's business income. Indeed, New Jersey has no doubt on this score. Counsel for the state explicitly acknowledged at oral argument that its approach would essentially eliminate the unitary business concept (Tr. 31-33, 39-40); all of a corporation's income would be regarded as "unitary" by definition. And New Jersey's income tax statute draws no distinction between tangible and intangible income. *See* N.J. Stat. Ann. §§ 54:10A-4 (k), 54:10A-5(c). New Jersey thus proposes to scrap—for both tangible and intangible income—what this Court has repeatedly described as "[t]he 'linchpin of apportionability' for state income taxation." *Exxon*, 447 U.S. at 223 (quoting *Mobil*, 445 U.S. at 439). Removing this "linchpin" will require the painstaking construction of a new system of apportionability, one that will be fraught

with more problems and ultimately will be less fair than the longstanding unitary business system.

3. *Abandoning Unitary Taxation Will Create Obstacles to a State's Ability to Tax Income Earned Within Its Borders*

New Jersey's request for authority to tax income earned by a non-unitary business inevitably carries with it a restriction on the authority of other states to tax income under a traditional, unitary business approach. Any new taxing power that the Court gives to New Jersey must be taken away from some other state. Otherwise, the new system that would emerge could not survive Commerce Clause scrutiny because it would yield inevitable multiple taxation of multistate corporations.

This Court has recognized for many years that permitting property taxation on the basis of apportionment is incompatible, as a matter of constitutional law, with full taxation by the state of domicile. In *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952), Ohio claimed the right to collect property tax on the full value of barges owned by an Ohio company. The Court rejected that claim because other states where the barges operated were empowered to tax the value of the barges on an apportioned basis. The Court explained (*id.* at 384-85): "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. . . . Otherwise there would be multiple taxation of interstate operations." *See also Braniff Airways, Inc. v. Nebraska State Bd. of Equalization & Assessment*, 347 U.S. 590, 601 (1954). In *Central Railroad Co. v. Pennsylvania*, 370 U.S. 607, 614 (1962), the Court reemphasized that the possibility of apportioned property taxation by other states "would render unconstitutional any domiciliary ad valorem tax at full value." *Id.*

The constitutional infirmity inherent in permitting taxation under both apportionment and allocation theories

formed the basis for this Court's holding in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). The Court there held that a state could not impose an apportioned property tax on foreign-owned instrumentalities of international commerce because that would pose an unacceptable "risk of international multiple taxation." *Id.* at 451-52. The Court explained the governing principle as follows (*id.* at 447): "The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full. . . . The basis for this Court's approval of apportioned property taxation, in other words, has been its ability to enforce full apportionment by all potential taxing bodies." Because the Court was not in a position to prevent the foreign country of domicile from taxing the full value of the property on an allocation theory, it held that the Commerce Clause prohibits a state from taxing a portion of that value on an apportionment theory. *Id.* at 447-48, 451-52.

The Commerce Clause barrier to allowing different states to use incompatible theories of taxing jurisdiction is equally present in the context of state income taxation, and the Court so held in *Mobil*. *See* 445 U.S. at 442-46. Mobil objected on multiple taxation grounds to the Court's holding that Vermont could tax a portion of the dividends received by a New York corporation so long as the dividend payor was part of the unitary business of the company doing business in Vermont. Mobil argued that this would violate the Commerce Clause because the domiciliary state was already permitted under established law to allocate 100% of those dividends to itself for unapportioned taxation (although in fact New York had not elected to tax the dividends).

This Court agreed with the basic principle of Mobil's multiple taxation argument—namely, that two distinct income taxation systems cannot be permitted to coexist if they provide for taxation of more than 100% of the taxpayer's income. "Taxation by apportionment and tax-

ation by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained." 445 U.S. at 444-45. The Court rejected Mobil's conclusion only because it believed that the conflict should be resolved by having New York's ability to tax 100% of dividend income yield in the face of Vermont's right to tax an apportioned share of the dividends. The Court ruled that, although the state of domicile is authorized "to lay *some* tax on [Mobil's] dividend income . . . there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States." *Id.* at 445-46 (emphasis added).

In *Mobil*, the Commerce Clause prohibition on incompatible taxation theories affected only the unique taxing authority historically accorded to the domiciliary state over dividend income—and then only to the extent dividends are received from a unitary subsidiary. But if New Jersey's position here is upheld, the longstanding authority of all states to tax economic activity occurring within their borders will be undermined. Just as apportionment and allocation are "incommensurate" theories of taxation, so too are full taxation on a discrete enterprise theory and New Jersey's approach of apportioned taxation on a common ownership theory without regard to whether businesses are unitary. Under the present system, the state in which a discrete business enterprise is located can fully tax the income from that business, without regard to whether the enterprise shares common ownership or affiliation with some other discrete businesses located in other states. But New Jersey now claims the right to tax a portion of the income from a discrete business enterprise operating outside New Jersey—on the basis of New Jersey's connection to an affiliated (but nonunitary) enterprise that does do business in New Jersey. Upholding that claim means that double taxation will inevitably result unless the first state in which the dis-

crete business enterprise is located is required also to apportion its tax.

This serious implication of New Jersey's argument is well illustrated by the example considered by the Court at oral argument and discussed earlier—that is, where a company operates through unincorporated divisions a beauty parlor business in New Jersey and a parking lot business exclusively in California. Under current law, California would tax the discrete enterprise that operates there; because the parking lot business operates entirely in one state, California would tax 100% of the income. But if New Jersey is upheld in its claim to tax an apportioned share of the parking lot income, California cannot be permitted to continue its practice of taxing the parking lot business in full as a discrete enterprise. As this Court made clear in *Mobil*, apportioned taxation by New Jersey coupled with 100% taxation by California of the same income runs afoul of the Commerce Clause. The Court would have to exercise "its ability to enforce full apportionment by all potential taxing bodies" (*Japan Line*, 441 U.S. at 447), not just by New Jersey. Thus, as counsel for the state acknowledged at oral argument (Tr. 43-44), the inevitable consequence of New Jersey's argument that it be *permitted* to tax non-unitary business income is that other states must be *prohibited* from taxing in full the income of businesses operating exclusively within their own state.

This departure from well settled state tax law would be a step backwards from the present system in terms of fairness and rationality because it would undermine the longstanding guiding principle that income should be taxed by the state in which value was earned. In expanding the power of states to tax non-unitary business income, New Jersey's proposal would correspondingly diminish the power of states to tax discrete businesses without apportionment, thereby redistributing tax revenues away from the states that contributed their services and protections to the generation of the income. If the park-

ing lot business were profitable and the beauty parlor business were not, the change would directly reduce California's tax revenue, in effect forcing California to cede to New Jersey some of its income tax base.

The irrationality and multiple taxation potential of New Jersey's proposal is exacerbated when non-business income is thrown into the mix. Suppose in our example that, in addition to the beauty parlor and parking lot businesses, the company conducted investment activities in its home state of Delaware. This situation would be uncomplicated under current law. California would be permitted to tax 100% of the parking lot income, New Jersey would be permitted to tax 100% of the beauty parlor income, and Delaware would be permitted to tax 100% of the investment income.

Adopting New Jersey's proposal, however, would introduce substantial confusion. New Jersey presumably would seek to tax an apportioned share of all the income of the corporation, including the parking lot income and the investment income (perhaps making some factor adjustment to account for the investment activities). Delaware might still seek to tax 100% of the investment income, though under *Mobil* it presumably would be constrained by New Jersey's taxation on an apportionment theory. California also would have a claim to some portion of the investment income under New Jersey's theory that the non-business income of a company can be taxed by any state in which that company does business, no matter how discrete its operations. Indeed, New Jersey's theory presumably would allow Delaware, on the basis of the investment activity, to tax a portion of the income from the New Jersey and California operations. It would be imprudent, at best, to jettison 70 years of settled law for the purpose of introducing this kind of chaos.

Finally, abandonment of the unitary business approach could harm the public fisc by opening the door for corporate tax planners to take steps that would result in

reduction of the aggregate state tax base. If a state is prohibited from taxing on a traditional unitary basis and instead must apportion on the basis of all the taxpayer's operations, including discrete enterprises operating only in other states, the state's tax base necessarily will be affected by all changes in a company's business, even when those changes bear no relation to the business activity that the state is trying to tax. This circumstance could tempt companies to invest in businesses that operate in states that have no, or relatively light, corporate income tax.

For example, if Nevada has no corporate income tax, the company operating beauty parlors in New Jersey and parking lots in California might purchase a supermarket chain in Nevada. The new investment would bring substantial tax benefits because a supermarket would have relatively significant apportionment factors, such as a high sales volume, coupled with relatively low net income. Incorporating those factors into the company's apportionment formula would draw income from the beauty parlor and parking lot businesses into Nevada for taxation. The company would then have succeeded in reducing its total state tax bill by reducing the amount of income available for taxation by California and New Jersey and attributing that income to Nevada, where no state income tax is imposed.

4. *Any Significant Departure from the Unitary Business Principle Should Come from Congress, Not from This Court*

Even if this Court were to agree with New Jersey as a matter of first principles that intangible income should be taxable without regard to the unitary business limitation, it would be inappropriate to overturn decades of established law to implement that conclusion. "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved." *Payne v. Tennessee*, 111 S. Ct.

2597, 2610 (1991). *See also National Bank v. Whitney*, 103 U.S. 99, 102 (1880). Taxation is one area where "it is more important that the applicable rule of law be settled than that it be settled right." *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting). That is particularly true in this context where the reliance interests are so strong for both multistate businesses and states.

Businesses have organized their affairs in justified reliance on the Court's established state tax jurisprudence, making decisions such as where to locate their headquarters and whether to acquire other businesses. The states have drafted their statutes to fit into the framework of the present system. Indeed, this Court has noted that the unitary business principle "forms the basis for" UDITPA, which is the product of an effort to achieve uniformity in this difficult area and which has been adopted by about half the states. *Container*, 463 U.S. at 165. The Court should not lightly dash the expectations of these parties, require states to revamp their tax codes, and create substantial "practical dislocation" of the established framework for operating, and taxing, multistate businesses. *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292, 300 (1944).

To the extent it is necessary to consider substantial changes in the system for state taxation of multistate corporations, Congress is much better equipped to handle that task than is this Court. Congress has tools at its disposal, such as the hearing process, to study the broad scope of the issue and the full ramifications of any changes. The Court is comparatively hampered in this regard because it must deal with the complex issues on the basis of single cases that come before it for adjudication. *See Northwest Airlines*, 322 U.S. at 299-300; *McCarroll v. Dixie Greyhound Lines, Inc.*, 309 U.S. 176, 189 (1940) (Black, J., dissenting). Unlike this Court, Congress also has the power to fine-tune its changes, through mech-

anisms such as transitional rules, to minimize the adverse impact on reasonable expectations. Congress also can legislate at a level of detail unavailable to the judiciary in order to promote rationality in a new system—for example, by delineating permissible methods of apportionment. *See generally ASARCO*, 458 U.S. at 349-53 (O'Connor, J., dissenting).

There is room for the exercise of congressional authority in this area even though the unitary business principle rests on constitutional foundations. Indeed, the Court explicitly stated in *ASARCO* that it viewed the scope of congressional authority as an open question, denying the dissent's accusation that the majority had " 'strip[ped] Congress of the authority' to authorize or regulate state taxation." *See* 458 U.S. at 327 n.23. Chief Justice Burger concurred in reliance "on the Court's express statement that the Court's holdings do not preclude future congressional action in this area." *Id.* at 331.

While the Court has invoked both the Due Process Clause and the Commerce Clause in its decisions, various Justices periodically have questioned whether the Fourteenth Amendment is truly the source of the restrictions on state taxing authority embodied in *ASARCO* and its predecessors. *See ASARCO*, 458 U.S. at 350 n.14 (O'Connor, J., dissenting); *Central Railroad Co. v. Pennsylvania*, 370 U.S. at 618-22 (Black, J., concurring); *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194, 211 (1905) (opinion of Holmes, J.). To the extent those restrictions rest solely on the Commerce Clause, there is no doubt that Congress can legislate to change them. *See, e.g., Western & Southern Life Ins. Co. v. State Board of Equalization*, 451 U.S. 648, 652-53 (1981).

Moreover, even if these restrictions do inevitably reflect due process considerations, that does not necessarily prohibit Congress from taking action. A nexus limitation on state taxation imposed by the Fourteenth Amendment

does not carry with it any analogous Fifth Amendment prohibition on federal action because there are no territorial barriers to federal taxation within the United States. Since the nexus "limits are inapplicable to federal regulation," it has been argued that Congress should "be able to remove them, regardless of whether the theoretical limit on state power stems from the due process clause or from the commerce clause." Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387, 401 (1983); *see also* Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993, 1022-28 (1986).

This argument finds support in *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408 (1946), which upheld Congress's authority to override this Court's Commerce Clause decisions. The Court stated that Congress's authority was limited only by constitutional provisions "designed to forbid action altogether by any power or combination of powers in our governmental system." *Id.* at 434-35. Where there is no constitutional prohibition on Congress's freedom of action, Congress may choose to exercise its authority "alone . . . or in conjunction with coordinated action by the states." *Id.* at 434.

In *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869 (1985), Justice O'Connor argued in dissent that the rationale of *Benjamin* extended beyond its Commerce Clause setting. She maintained that a discriminatory state insurance tax could not be struck down as violative of the Equal Protection Clause if it was authorized by the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015. She explained that the federal statute would override the constitutional prohibition on state discrimination against out-of-state business because "any federalism component of equal protection is fully vindicated where Congress has explicitly validated a parochial focus." 470 U.S. at 899 (O'Connor, J., dissenting).

The full Court did not reach this issue in *Metropolitan Life* because the majority did not agree that McCarran-Ferguson authorized states to pass protectionist legislation that would violate equal protection. More recently, however, the Seventh Circuit has reached the same issue of congressional authority in a different context and has explicitly embraced the conclusion suggested by Justice O'Connor. *Milwaukee County Pavers Ass'n v. Fiedler*, 922 F.2d 419, *cert. denied*, 111 S. Ct. 2261 (1991). Analogizing to the Commerce Clause, the court held that Congress could authorize the states to engage in affirmative action programs that would otherwise be constitutionally prohibited so long as Congress itself could have implemented the programs. Congress had merely "enlisted states as its agents." *Id.* at 424.

These authorities suggest that "Congress can consent to state laws where constitutional restrictions bind the states but not Congress" (Cohen, *supra*, at 406), which would include state tax measures that offend nexus requirements embodied in the Fourteenth Amendment. Congress and the states are not "forbidden to cooperate . . . to achieve legislative consequences, particularly in the great fields of regulating commerce and taxation, which, to some extent at least, neither could accomplish in isolated exertion." *Prudential Ins. Co. v. Benjamin*, 328 U.S. at 439.[1]

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[1] In any event, even if Congress cannot override entirely a ruling rooted in the Due Process Clause, its pronouncements should, at minimum, inform this Court's consideration. Under Article I, section 8, Congress is the expert in the area of commercial relations—both interstate and foreign. As a consequence, a congressional judgment concerning the allocation of multistate business income is entitled to considerable deference. As Chief Justice Marshall stated for the Court in *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 401 (1819), "[a]n exposition of the constitution, deliberately established by legislative acts, . . . ought not to be lightly disregarded." *See also Walters v. National Ass'n of Radiation Survivors*, 473 U.S. 305, 318-19 (1985). While the Court might reach one conclusion where it is writing on a blank slate, it might come to a different one where a comprehensive federal enactment forms the backdrop.

II. A DECISION OVERRULING *ASARCO* AND *WOOLWORTH* SHOULD APPLY ONLY PROSPECTIVELY

If the Court decides to abandon the unitary business principle and to overturn *ASARCO* and *Woolworth*, the new rule should apply only prospectively to tax years commencing after the date of the decision. We recognize that the Court is divided over whether it may ever accord purely prospective effect to its rulings. *See James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). But unless a majority is prepared to embrace the rule of automatic retroactivity advanced by the concurring Justices in *Beam* (*see id.* at 2449 (Blackmun, J., concurring) and 2450 (Scalia, J., concurring)), this is among the strongest cases imaginable for pure prospectivity under the traditional three-prong test of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971).

First, a decision repudiating *ASARCO* and *Woolworth* would self-evidently "establish a new principle of law . . . by overruling clear past precedent on which litigants may have relied." 404 U.S. at 106. Far more clearly than in *American Trucking Associations v. Smith*, 110 S. Ct. 2323 (1990)—where the overruled line of authority had already been substantially eroded before it was finally discarded (*see id.* at 2331 (plurality opinion))—an overruling in this case would amount to a sudden and unexpected about-face.

Second, retroactive application of a new rule would not "further"—on the contrary, it would "retard"—the underlying constitutional policies. *Chevron*, 404 U.S. at 107. Certainty in matters of tax law is critical to an efficient national economy. Retrospective abrogation of state taxing limitations would replace certainty with volatility, would unsettle interstate markets, and would disserve Commerce Clause values. Multistate businesses would be forced to weigh the possibility that their projected returns will be reduced by unforeseeable retroactive changes in constitutional tax doctrine. If companies cannot plan their business affairs with confidence in this

Court's authoritative pronouncements concerning the outer boundaries of state taxing authority, they are at least marginally discouraged from engaging in robust interstate trade.

Nor does any policy of the Due Process Clause require retroactivity. If this Court were to conclude that the due process holdings of *ASARCO* and *Woolworth* too narrowly confine the taxing powers of non-domiciliary states, a prospective change would be sufficient to release those constraints and restore to the states whatever additional jurisdictional authority the Court believes they have. Retrospective exercise of such authority would not further any due process principle. The Clause is fully vindicated if the reach of state taxing power is correctly circumscribed; it is wholly neutral concerning whether a state in fact collects taxes to the limit of its powers. If anything, the retroactive imposition of new tax liabilities for past conduct would be abhorrent to traditional due process norms, at least insofar as it "unduly interfer[es] with settled expectations." *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238, 2252 n.23 (1990).

Third, retroactive application of a decision overruling *ASARCO* and *Woolworth* would produce "substantial inequitable results." *Chevron*, 404 U.S. at 108. Business taxpayers have structured their operations over many decades in reliance on this Court's unbroken line of constitutional decisions predicating the apportionability of income on the unitary business principle. Nothing in any of the Court's prior decisions would have alerted taxpayers to the possibility of a dramatic change in the applicable rules. When, as in this instance, affected parties "cannot be expected to foresee that a decision of this Court would overturn established precedents, the inequity of unsettling actions taken in reliance on those precedents is apparent." *American Trucking Ass'ns v. Smith*, 110 S. Ct. at 2333 (plurality opinion).

The risk of gross inequity is especially acute in the present context, because retroactive imposition of a new state taxing regime would open the door to multiple taxation. Taxpayers could well find themselves exposed to a wave of new retroactive assessments by non-domiciliary states asserting the power to tax an apportioned share of intangible income that has already been taxed in full by the domiciliary state. Because of differing statutes of limitations, however, the same taxpayers may be foreclosed from seeking refunds from the domiciliary state and could therefore wind up paying multiple state taxes on the same income. The potential competitive dislocations and financial disruptions are inestimable. Conversely, some states may be exposed to a raft of refund claims from domiciliary corporations but may be foreclosed in some cases from issuing new assessments to non-domiciliaries whose prior tax years are closed. The consequent retrospective reallocation of tax dollars among the states and tax liabilities among taxpayers would likely produce a needless flood of new litigation and significantly distort commercial marketplaces with inequitable results for all concerned.

Even if a majority of the Court were to adopt a principle of automatic retroactivity in civil cases, the equitable considerations discussed above should counsel strongly against overuling *ASARCO* and *Woolworth*. As the concurring Justices in *Beam* noted, a rule of automatic retroactivity "forces us to consider the disruption that our new decisional rules cause" and "combines with *stare decisis* to prevent us from altering the law each time the opportunity presents itself." 111 S. Ct. at 2540 (Blackmun, J., concurring). Given the potential in this case for massive economic dislocations if the Court were to " 'make new law' " (*id.* at 2451 (Scalia, J., concurring)), it should be particularly loath to take that drastic step here.

CONCLUSION

The judgment of the Supreme Court of New Jersey should be reversed.

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APRIL 1992

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

In The
SUPREME COURT OF THE UNITED STATES
October Term, 1991

ALLIED-SIGNAL INC.
as successor in interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF THE FINANCIAL INSTITUTIONS STATE TAX COALITION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Irrespective of whether this Court overrules ASARCO, Inc. v. Idaho State Tax Comm'n., 458 U.S. 307 (1982) and F.W. Woolworth Co. v. Taxation and Revenue Dep't., 458 U.S. 354 (1982), what constitutional principles should govern state taxation of corporations doing business in several states, in order to protect corporations engaged in interstate commerce from overlapping and conflicting state taxation?

TABLE OF CONTENTS

Page

QUESTION PRESENTED FOR REVIEW i

TABLE OF AUTHORITIES iv

INTEREST OF AMICUS CURIAE 1

SUMMARY OF THE ARGUMENT 2

IRRESPECTIVE OF WHETHER ASARCO AND WOOLWORTH ARE OVERRULED, THIS COURT SHOULD HOLD THAT MULTIPLE TAXATION BY STATES IS UNCONSTITUTIONAL 3

A. THIS CASE HIGHLIGHTS THE PREVALENT RISK OF MULTIPLE STATE TAXATION OF MULTISTATE BUSINESSES 4

B. IF ASARCO AND WOOLWORTH ARE OVERRULED, DIVIDENDS AND GAINS ON SALE OF STOCK SHOULD NOT BE HELD SUBJECT TO NONDOMICILIARY STATE TAXATION OF AN APPORTIONED BASIS UNLESS SUCH INCOME CONSTITUTES BUSINESS INCOME 5

C. MULTIPLE TAXATION ARISING FROM DISCRIMINATORY APPORTIONMENT FORMULAS OF NONDOMICILIARY STATES IS UNCONSTITUTIONAL UNDER THE COMMERCE CLAUSE 7

1. Aggressive Efforts By States To Shift Tax Burdens To Nondomiciliary Businesses Highlight The Need To Overrule Moorman 7

2. Apportionment And Sourcing Rules That Look Primarily Or Solely To The Destination Of Sales And Disregard The Location Of Other Income-Producing Activities Are Unconstitutional Under The Commerce Clause 10

CONCLUSION 12

TABLE OF AUTHORITIES

Page(s)

CASES:

ASARCO, Inc. v. Idaho State Tax Comm'n.,
458 U.S. 307 (1982) . . . . . passim

Complete Auto Transit, Inc. v. Brady,
430 U.S. 274 (1977) 10

Container Corp. of America v. Franchise Tax Board,
463 U.S. 159 (1983) 6,10,11

Hans Rees' Sons v. North Carolina,
283 U.S. 123 (1931) 8

F.W. Woolworth Co. v. Taxation and Revenue Dep't.,
458 U.S. 354 (1982) i,2,5

Mobil Oil Corp. v. Comm'r of Taxes,
445 U.S. 425 (1980) 7

Moorman Manufacturing Co. v. Bair,
437 U.S. 267 (1978) . . . . . passim

Trinova Corp. v. Michigan Treasury Dept.,
111 S.Ct. 818 (1991) 11

Page(s)

STATUTES:

Ariz. Rev. Stat. Ann. §43-1139 9
Conn. Gen. Stat. §12-218 9
Fla. Stat. §220.15(4) 9
Ga. Code Ann. §48-7-31(d)(1)(B) 9
Ill. Rev. Stat. Ch. 120, §3-304(a) 9
Ind. Code §6-5.5-2-4 9
Ky. Rev. Stat. Ann. §141.120(8) 9
Me. Rev. Stat. Ann. tit. 36, §5211.8 9
Mass. Gen. L. Ch. 63, §38(c) 9
Mich. Stat. Ann. §208.45 9
Minn. Stat. §290.191.3 9
Neb. Rev. Stat. §77-2734.05 9
N.H. Rev. Stat. Ann. §77-A:3,I 9
N.H. Rev. Stat. Ann. §77-A:3,II(a) 9
Ohio Rev. Code Ann. §5733.05(B)(2) 9
Or. Rev. Stat. §314.650 9
S.C. Code Ann. §12-7-1190 9
Tenn. Code Ann. §67-4-815 9
W.Va. Code §11-24-7b(b)(4)(A) 9
Wis. Stat. §71.25(6) 9

UNIFORM LAWS:

Uniform Division of Income for Tax Purposes
Act, 7A Uniform Laws Annotated 331
(West 1985) §1(a) 3,6

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BRIEF OF THE FINANCIAL INSTITUTIONS STATE TAX COALITION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

The Financial Institutions State Tax Coalition (hereinafter the "Coalition") hereby respectfully submits this brief as amicus curiae in support of the Petitioner in the above captioned matter. The written consent of both of the parties has been obtained and filed with the Clerk of this Court.

The Coalition is an ad hoc committee comprised of a cross-section of financial institutions and financial service

providers throughout the United States[1] that are engaged in multistate financial services businesses. The Coalition was organized to promote and support equitable and nondiscriminatory state tax policies governing multistate financial institutions and financial services providers. The Coalition's members are directly affected by state taxation of interstate operations.

The Coalition respectfully submits this brief in response to the Court's invitation of amici to address constitutional principles in the event ASARCO and Woolworth are overruled. The Coalition urges this Court to enunciate constitutional principles that will protect taxpayers from the threat of multiple taxation arising from the Allied-Signal decision. These principles are of tremendous importance to the commercial banking and financial services industries.

SUMMARY OF THE ARGUMENT

If this Court overrules ASARCO and Woolworth, it should be recognized that dividends and gains from stock investments can only be taxed on an apportioned basis

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[1]The Coalition's members include: Bank of America NT&SA; The Bank of New York Company, Inc.; Capital Holding Corporation; The Chase Manhattan Bank, N.A.; Citicorp/Citibank, N.A.; Dean Witter Financial Services Group Inc.; First Chicago Corporation; First Interstate Bancorp; KeyCorp; Morgan Guaranty Trust Company of New York; NationsBank; Security Pacific Corporation; and Wachovia Corporation.

consistent with the Commerce Clause if they are business income as defined by the Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985), §1(a). This Court should further rule that no state can constitutionally allocate and tax 100 percent of such dividends and gains.

In any case, this Court should make clear that sourcing rules governing all items of business income should be consistent with the activities producing such income. In that regard, apportionment formulas that largely disregard income-producing activities (viz., capital and labor) and that focus disproportionately upon sales according to customer location are unconstitutional. Such formulas, which have become more common since Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978), discriminate against multistate business in violation of the Commerce Clause. In order to protect interstate commerce from such multiple taxation, this Court should overrule Moorman.

ARGUMENT

I. IRRESPECTIVE OF WHETHER ASARCO AND WOOLWORTH ARE OVERRULED, THIS COURT SHOULD HOLD THAT MULTIPLE TAXATION BY STATES IS UNCONSTITUTIONAL.

A. THIS CASE HIGHLIGHTS THE PREVALENT RISK OF MULTIPLE STATE TAXATION OF MULTISTATE BUSINESSES.

The Allied-Signal case is a clear example of the risk of multiple taxation borne by multistate businesses. The risk is that different states, with divergent and conflicting rules for allocating and apportioning income, will together subject the income of the business to multiple taxation. In deciding this case, this Court should protect interstate commerce from this "parochial hodgepodge of overlapping and conflicting tax levies" (ASARCO, 458 U.S. at 331 (O'Connor, J., dissenting)).

This case brings into focus the conflicts between taxing rules of the various states where a multistate taxpayer does business. If the nondomiciliary state is allowed to tax capital gain upon sale of stock as apportionable business income, what would prevent the domiciliary state from taxing all of the same gain as allocable nonbusiness income? Even if the domiciliary state taxes the capital gain as apportionable business income, what protection does a multistate business have against multiple state taxation arising from inconsistent apportionment formulas in the states where it is taxable? These conflicts would be exacerbated if the definition of

apportionable income is expanded, as New Jersey seeks to do in the present case.

Although the Coalition expresses no opinion as to whether ASARCO and Woolworth should be overruled, we urge this Court to enunciate constitutional principles to guard against multiple state taxation in any event.

B. IF ASARCO AND WOOLWORTH ARE OVERRULED, DIVIDENDS AND GAINS ON SALE OF STOCK SHOULD NOT BE HELD SUBJECT TO NONDOMICILIARY STATE TAXATION ON AN APPORTIONED BASIS UNLESS SUCH INCOME CONSTITUTES BUSINESS INCOME.

If ASARCO and Woolworth are overruled, dividends and gains (or losses) on sale of stock[2] should be taxed on an apportioned basis by nondomiciliary states that have jurisdiction over the recipient corporation, only if the

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[2]Dividends from stock and gains and losses on sale of stock should be treated consistently for this purpose. Each of these items represents a return on the investment in the stock, differing only in the timing of when income and gains or losses are realized and distributed by the underlying corporation. See ASARCO, 458 U.S. at 330.

acquisition, management, and disposition of that stock constitute integral parts of the taxpayer's regular trade or business operations.[3] This constitutional rule should apply regardless of whether the activities of the corporation that issued the stock formed part of the recipient's unitary business (provided, however, such dividend, gain or loss may otherwise be eliminated under rules applicable to combined reports of unitary groups).

If such dividends, gains or losses are treated as business income subject to apportionment, they should be sourced as receipts for purposes of the apportionment formula to the location where the taxpayer manages the stock investment. If intangible property is included in the apportionment formula, the stock should be similarly sourced for purposes of the property factor. These sourcing rules are consistent with the rationale for business income treatment and properly reflect how the income is generated. See Container Corp. of America v. Franchise Tax Board, 453 U.S. 159, 169 (1983).

In addition, no state should constitutionally be permitted to allocate and tax 100 percent of such dividends and gains that are properly taxed on an apportioned basis by

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[3]This standard is derived from §1(a) of the Uniform Division of Income for Tax Purposes Act, supra.

other states where the recipient is taxable. This rule will help to protect multistate businesses from multiple taxation of apportionable income. See Mobil Oil Corp. v. Comm'r. of Taxes of Vermont, 445 U.S. 425, 443-445 (1980). While we realize that the adoption of such a rule is contrary to dictum in Moorman, 437 U.S. at 279, for the reasons set forth below, both this dictum and the holding in Moorman merit reexamination.

C. MULTIPLE TAXATION ARISING FROM DISCRIMINATORY APPORTIONMENT FORMULAS OF NONDOMICILIARY STATES IS UNCONSTITUTIONAL UNDER THE COMMERCE CLAUSE.

1. Aggressive Efforts By States To Shift Tax Burdens To Nondomiciliary Businesses Highlight The Need To Overrule Moorman.

In Moorman, this Court upheld Iowa's use of a single-factor sales formula against constitutional challenge. The taxpayer was an Illinois manufacturer whose products were sold to customers in Iowa and other states. The taxpayer -- subject to tax in Illinois under a three-factor apportionment formula -- contended that Iowa's single-factor formula resulted in taxation of a greater portion of its income than was reasonably attributable to its business in the state.

In upholding Iowa's single-factor formula against the taxpayer's Commerce Clause challenge, this Court held that the taxpayer had the burden of proof that application of a particular apportionment formula produces duplicative taxation and failed to meet that burden[4]. This Court declined to endorse the generally prevailing three-factor formula as a uniform rule for the division of income. Instead, this Court observed that "[i]t is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income." 437 U.S. at 280.

Many states have relied upon the holding in Moorman to justify shifting state tax burdens from local businesses to nondomiciliary businesses. As noted infra, single-factor sales formulas operate to tax income of out-of-state businesses disproportionately to business transacted within and without the state. The single-factor sales formula, used by Iowa and upheld in Moorman, is no longer a curious anomaly, but is

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[4]The taxpayer in Moorman also raised a due process argument claiming that Iowa's formula resulted in extraterritorial taxation. This Court ruled against the taxpayer on this issue holding that the taxpayer had failed to impeach formula apportionment through separate accounting. Notwithstanding the suggestion in footnote 9 of the opinion that such a showing might be possible, (437 U.S. at 275-6), no taxpayer has ever been successful before this Court attacking a state net income or franchise tax on these grounds since the 1931 decision in Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931).

instead a growing threat to multistate businesses that provide products or services from the home state to customers in many states.[5] Other states have aimed at the same result by increasing the weight of the sales factor in the standard apportionment formula of property, payroll, and sales.[6] In the past fourteen years since Moorman, Congress has failed to enact any uniform rules.

The growing burden upon interstate commerce from such multiple taxation warrants further action by this Court. This Court need not promulgate comprehensive uniform rules of multistate taxation as it rightly declined to do in Moorman. Instead, this Court should address the problem of multiple taxation by invalidating apportionment formulas that disregard the fact that capital and labor are major income producing activities.

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[5]At least 6 states now utilize a single-factor apportionment formula applicable to various types of financial and/or non-financial businesses. See, e.g., Ga. Code Ann. §48-7-31(d)(1)(B); Ind. Code §6-5.5-2-4; Neb. Rev. Stat. §77-2734.05; S.C. Code Ann. §12-7-1190; Tenn. Code Ann. §67-4-815; and W.Va. Code §11-24-7b(b)(4)(A).

[6]See, e.g., Ariz. Rev. Stat. Ann. §43-1139; Conn. Gen. Stat. §12-218; Fla. Stat. §220.15(4); Ill. Rev. Stat. Ch. 120, §3-304(a); Ky. Rev. Stat. Ann. §141.120(8); Me. Rev. Stat. Ann. tit. 36, §5211.8; Mass. Gen. L. Ch. 63, §38(c); Mich. Stat. Ann. §208.45; Minn. Stat. §290.191.3; N.H. Rev. Stat. Ann. §77-A:3,I and §77-A:3,II(a); Ohio Rev. Code Ann. §5733.05(B)(2); Or. Rev. Stat. §314.650 and Wis. Stat. §71.25(6).

2. Apportionment And Sourcing Rules That Look Primarily Or Solely To The Destination Of Sales And Disregard The Location Of Other Income-Producing Activities Are Unconstitutional Under The Commerce Clause.

In Moorman, this Court observed that the Commerce Clause "is neutral with respect to the content of any uniform rule" for the division of income. 437 U.S. at 279. This neutrality, however, must not override the constitutional prohibitions of unfair apportionment and discrimination against interstate commerce set forth in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). Thus, although the Commerce Clause does not define the ideal uniform rule for the division of income, it must be read to disapprove certain formulas that promote multiple and discriminatory tax burdens by disregarding fundamental income-producing activities outside the state.

A state must apportion unitary business income "on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." Container, 463 U.S. at 164-65. An apportionment formula that largely or entirely disregards the location of capital and labor, and focuses primarily or solely upon sales according to customer location, discriminates in favor of local businesses with out-of-state sales and against out-of-state businesses with in-state sales. Such a formula

apportions a greater percentage of income of out-of-state businesses and a smaller percentage of the income of local businesses than does a three-factor formula that gives equal weight to property and payroll.[7] It is precisely this discriminatory impact that the Commerce Clause prohibits.

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[7]The three-factor formula, by contrast, reflects a "very large share" of the income producing activities. Container, 463 U.S. at 183; Trinova Corp. v. Michigan Treasury Dept., 111 S.Ct. 818, 112 L.Ed. 2d at 911 (1991).

CONCLUSION

As the above argument points out, this Court should articulate principles to ensure that multistate businesses are not subjected to multiple and discriminatory state taxation.

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April 10, 1992

No. 91-615

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

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BRIEF OF AMICI CURIAE AMWAY CORPORATION, ASEA BROWN BOVERI, INC., ASHLAND OIL, BORDEN, INC., AND THE LIMITED STORES IN SUPPORT OF PETITIONER ON REARGUMENT

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
STATEMENT OF INTEREST	1
INTRODUCTION AND SUMMARY OF ARGUMENT	2
ARGUMENT	5
I. THE UNITARY PRINCIPLE SHOULD BE PRESERVED SINCE IT ALLOWS STATES TO REACH THE FULL MEASURE OF THEIR TAXING AUTHORITY WHILE PROVIDING IMPORTANT PROTECTION TO MULTI-STATE BUSINESSES	5
II. OVERRULING *ASARCO* AND *WOOLWORTH* TO PERMIT NON-DOMICILIARY STATES TO REACH PASSIVE INVESTMENT INCOME WOULD BE BOTH UNWARRANTED AND DISRUPTIVE	9
III. THE COURT SHOULD MAINTAIN STABILITY IN THE AREA OF STATE TAXATION	14
A. Considerations of *Stare Decisis* Counsel Adherence to this Court's Decisions	15
B. The Failure of Congress To Legislate in this Area also Counsels this Court Not To Overrule *ASARCO* and *Woolworth*	20
IV. IF THIS COURT ABANDONS THE UNITARY BUSINESS PRINCIPLE, IT SHOULD REQUIRE THAT STATES ENGAGE IN FAIR APPORTIONMENT	22
CONCLUSION	28

TABLE OF AUTHORITIES

Cases

ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) ..... *passim*
Adams Express Co. v. Ohio State Auditor, 166 U.S. 185 (1897) 6
Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 6, 7
Amerada Hess Corp. v. Conrad, 410 N.W.2d 124 (N.D. 1987) 27
Amerada Hess Corp. v. Director, N.J. Div. of Taxation, 490 U.S. 66 (1989) 2, 22, 24, 25
American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266 (1987) 25
Arizona v. Rumsey, 467 U.S. 203 (1984) 14
Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) 3, 24
Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) 25
Bass, Ratcliff & Gretton Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) 6
Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) 26
Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977) 3, 25
Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932) 21
Butler Bros. v. McColgan, 315 U.S. 501 (1942) 6
Caterpillar Tractor Co. v. Department of Revenue, 618 P.2d 1261 (Ore. 1980) 8
CBS Inc. v. Comptroller of the Treasury, 575 A.2d 324 (Md. 1990) 27
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 18, 19, 20
City of Akron v. Akron Center for Reproductive Health, Inc., 462 U.S. 416 (1983) 14
Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) 21
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 2, 12, 13, 24
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 11, 12, 13, 23, 27

TABLE OF AUTHORITIES—Continued

	Page
Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977)	21
Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984)	15
Corn Products Refining Co. v. Commissioner of Internal Revenue, 350 U.S. 46 (1955)	12
Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980)	11, 15, 16
F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354 (1982)	*passim*
Fargo v. Hart, 193 U.S. 490 (1904)	25
Farmers Loan & Trust Co. v. Minnesota, 280 U.S. 204 (1930)	10
Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939)	6
Fort Howard Paper Co. v. Oklahoma Tax Comm'n, 792 P.2d 87 (Okla. App. 1989)	27
General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965)	26
General Motors Corp. v. Washington, 377 U.S. 436 (1964)	5
Goodman v. Lukens Steel Co., 482 U.S. 656 (1987)	15
Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931)	6, 23
Helvering v. Griffiths, 318 U.S. 371 (1943)	18
Helvering v. Hallock, 309 U.S. 106 (1940)	16
James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439 (1991)	17
Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979)	24
McCarroll v. Dixie Greyhound Lines, Inc., 309 U.S. 176 (1940)	21
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)	*passim*
Monell v. Department of Social Services, 436 U.S. 658 (1978)	14, 16, 17, 21
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Moragne v. States Marine Lines, Inc., 398 U.S. 375 (1970)	16

TABLE OF AUTHORITIES—Continued

Page

National Bank v. Whitney, 103 U.S. 99 (1880) 17, 21
National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967) 10
Nippert v. Richmond, 327 U.S. 416 (1946) 25
Norfolk & Western R. Co. v. Missouri State Tax Comm'n, 390 U.S. 317 (1868) 10, 23, 27
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) 6, 21
Patterson v. McLean Credit Union, 491 U.S. 164 (1989) 14, 15
Payne v. Tennessee, 111 S. Ct. 2597 (1991) 14, 16
Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891) 6
Quill Corp. v. North Dakota, No. 91-194 (U.S. cert. granted Oct. 7, 1991) 4, 22
Southern Ry. Co. v. Kentucky, 274 U.S. 76 (1927) .. 25
Standard Oil Co. v. Peck, 342 U.S. 382 (1952) 24
State Railroad Tax Cases, 92 U.S. 575 (1876) 6
Swift & Co. v. Wickham, 382 U.S. 111 (1965) 18
Thomas v. Washington Gas Light Co., 448 U.S. 261 (1980) 16
Thornburgh v. American College of Obstetricians and Gynecologists, 476 U.S. 747 (1986) 14
Trinova Corp. v. Michigan Dep't of Treasury, 111 S.Ct. 818 (1991) ..... *passim*
True v. Heitkamp, 470 N.W.2d 582 (N.D. 1991) 27
Twentieth Century-Fox Film Corp. v. Department of Revenue, 700 P.2d 1035 (Or. 1985) 27
Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue, 483 U.S. 232 (1987) 24
Union Tank Line Co. v. Wright, 249 U.S. 275 (1919) 25
United States Glue Co. v. Oak Creek, 247 U.S. 321 (1918) 7
United States v. South Buffalo R. Co., 333 U.S. 771 (1948) 21
Vasquez v. Hillery, 474 U.S. 254 (1986) 16
Wallace v. Hines, 253 U.S. 66 (1920) 5, 6, 7, 25

TABLE OF AUTHORITIES—Continued

	Page
Walling v. Halliburton Oil Well Cementing Co., 331 U.S. 17 (1947)	17
Welch v. Texas Dep't of Highways and Public Transportation, 483 U.S. 468 (1987)	14
Western Union Telegraph Co. v. Taggart, 163 U.S. 1 (1896)	6
Westinghouse Electric Corp. v. Tully, 466 U.S. 388 (1984)	24
Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1936)	10
Williams v. Florida, 399 U.S. 78 (1980)	16
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)	8, 12
United States Constitution	
U.S. Const. art. I, § 8, cl. 3	2, 20
U.S. Const. amend. XIV, § 1	2, 15, 18, 20
Statutes	
28 U.S.C. § 1341 (1988)	25
Cal. Rev. & Tax Code § 25663 (West 1979 & Supp. 1992)	18
Md. Code Ann. Tax-General § 10-402(a) (1988 & Supp. 1991)	27
Mont. Code Ann. § 15-31-312 (1991)	27
N.J. Stat. Ann. § 54:10A-8 (West 1986)	27
Or. Rev. Stat. § 314.670 (1991)	27
Wis. Stat. § 1087m-1 (1911)	10
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TABLE OF AUTHORITIES—Continued

Page

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P. Hartman, *Collection of the Use Tax on Out-of-State Mail Order Sales*, 39 Vand. L. Rev. 993 (1986) 21
The Federalist, No. 78 (A. Hamilton) (H. Lodge ed. 1888) 14
Uniform Division of Income for Tax Purposes Act § 1(a) & (e) 11, 12, 16, 26, 27
W. Knepper, *Liability of Corporate Officers and Directors* § 14.02 (3d ed. 1978) 17
W. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747 (1957) 13
1 State Tax Guide (CCH) ¶ 10-110 8
1920 Model Business Income Tax Act 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-615

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF AMICI CURIAE AMWAY CORPORATION, ASEA BROWN BOVERI, INC., ASHLAND OIL, BORDEN, INC., AND THE LIMITED STORES IN SUPPORT OF PETITIONER ON REARGUMENT

STATEMENT OF INTEREST[1]

Amici are multistate and multinational companies that are engaged extensively in interstate commerce. These companies, although representing different industries, have an interest in avoiding duplicative, burdensome, and discriminatory state taxation, and in the orderly development of the law in this area.

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[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of this Court.

Amici did not file a brief in this case when it was first argued, and have not now briefed the question of how this case should be resolved under this Court's settled case law. However, they oppose New Jersey's position in this case that the Court should dispense with the unitary business principle and overrule *ASARCO v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F. W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982).

INTRODUCTION AND SUMMARY OF ARGUMENT

In the area of state taxation, the protections of the Commerce Clause and the Due Process Clause are nearly identical.[2] As this Court summarized in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), the constitutional requirements are satisfied if "the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." This test, although formulated to meet Commerce Clause standards, "encompasses as well the Due Process requirement that there be 'a minimal connection between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. 818, 828 (1991) (quoting *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980) (internal quotations omitted)).

This case implicates two of those requirements: nexus and fair apportionment. But underlying both of those requirements is the central purpose of the Commerce Clause—to prevent discrimination against interstate com-

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[2] *See Trinova Corp. v. Michigan Dep't of Treasury*, 111 S.Ct. 818, 828 (1991); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 443 (1980); *Amerada Hess Corp. v. Director, N.J. Div. of Taxation*, 490 U.S. 66, 80 (1989) (Scalia, J., concurring).

merce. Where a state seeks to tax values beyond its borders, either by allocating income to the state as to which there is no nexus or by unfair apportionment, there is a risk that the state may be discriminating against interstate commerce in two ways.

To begin with, the taxing state may be seeking to eliminate a competitive advantage enjoyed by another state that has determined to attract interstate businesses through a lower tax rate or a narrower tax base. For example, a state seeking to encourage business within its borders may choose to exempt from taxation certain kinds of passive income of corporations having their commercial domicile in the state. This Court only last Term made clear the legitimacy of a state tax policy designed to attract such business,[3] and the threat to such competition posed by extraterritorial taxation is obvious. If other states can tax income that is not rightfully subject to their jurisdiction or tax a disproportionate share of income, any advantage conferred by the low-tax state would be, at the very least, substantially diluted.

Additionally, the taxing state may in fact be discriminating against interstate commerce by creating a taxing scheme that, while facially neutral, imposes disproportionate burdens on interstate business. A state tax formula that is "significantly out of line" with the practices in other states may in fact be designed to discriminate against out-of-state business, thereby harming interstate commerce.[4]

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[3] *See Trinova*, 111 S.Ct. at 835 ("States are free to 'structur[e] their tax systems to encourage the growth and development of intrastate commerce and industry' ") (quoting *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 324-328 (1977)); *Armco, Inc. v. Hardesty*, 467 U.S. 638, 645-646 (1984).

[4] *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 295 (1978) (Powell, J. dissenting). *See also* Note, *State Taxation of Interstate Business and the Multistate Tax Compact: The Search for a Delicate Uniformity*, 11 Colum. J. Law & Soc. Probs. 231, 236-237 and nn.15-16 (1975).

Inconsistent state interests and laws have long stymied attempts to impose federal uniformity in the area of interstate taxation.[5] In the meantime, states have become increasingly aggressive in interstate taxation.[6] However, the unitary business principle has for over a century stood as a protection against such extraterritorial and potentially discriminatory taxation. The State in this case seeks to eviscerate that protection. At the argument in this case, New Jersey for the first time requested that this Court overrule *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982), on two grounds.[7] Tr. at 31-32. First, the State urged that nondomiciliary states be permitted to apportion the unrelated passive investment income of unitary businesses. Second, New Jersey urged that the unitary business principle be abandoned entirely so that all income may be apportioned by any state in which the overall business conducts any operations. For example, if a corporation with one affiliate manufacturing computers on the East Coast has a wholly separate affiliate operating an amusement park on the West Coast, it may now structure its operations so that there is no relationship, apart from common ownership, between the East Coast affiliate and the West Coast operation. Nonetheless, under New Jersey's argument, the state with the computer business would apportion the income generated from the entire enterprise, despite the complete absence of a connection between that state and the amusement park business.

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[5] *See, e.g.*, E. Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171, 177 (1970).

[6] *See e.g., Quill Corp. v. North Dakota*, No. 91-194 (U.S. cert. granted Oct. 7, 1991).

[7] Although New Jersey did not urge these positions in its initial brief in this Court, the argument was raised by California and eight other states in their brief *amici curiae*. *See* Cal. Am. Br. 20. References herein to "Tr." are to the Transcript of Oral Argument (March 4, 1992).

While states may, consistent with Due Process, look beyond their borders to "get the true values of the things within it," it has long been this Court's position that the Constitution does not permit this authority to "expose the heel of the system to a mortal dart—not, in other words, to open to taxation what is not within the State." *Wallace v. Hines*, 253 U.S. 66, 69 (1920) (Holmes, J.). And as the Court reiterated just two Terms ago in *Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. at 836, the Constitution is "a defense against state taxes which . . . either give rise to serious concerns of double taxation, or attempt to capture tax revenues that, under the theory of the tax, belong of right to other jurisdictions."

A primary protection in this area has been the unitary business principle, which has long stood as "the linchpin of apportionability. . . ." *Mobil Oil Corp.*, 445 U.S. at 439. The rules with respect to the attribution of income of passive investments have produced a similar, but more limited protection. No one is suggesting that this Court should attempt to issue a uniform state code of taxation, but neither should the Court eviscerate the protection against unfair, burdensome, and discriminatory taxation provided by the unitary business principle and the passive investment rule.

ARGUMENT

I. THE UNITARY PRINCIPLE SHOULD BE PRESERVED, SINCE IT ALLOWS STATES TO REACH THE FULL MEASURE OF THEIR TAXING AUTHORITY WHILE PROVIDING IMPORTANT PROTECTION TO MULTISTATE BUSINESSES.

For a century, the unitary business principle has governed state taxation, serving as both a grant of authority to states to look beyond their borders (in order to value properly the instate activities of a multistate business) and as a bar to taxing values that are unrelated to the instate activities of a business. *See, e.g., General Motors Corp.*

v. Washington, 377 U.S. 436, 439 (1964); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959); *Butler Bros. v. McColgan*, 315 U.S. 501, 508 (1942); *Ford Motor Co. v. Beauchamp*, 308 U.S. 331, 336 (1939); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 132-133 (1931); *Bass, Ratcliff & Gretton Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924); *Wallace v. Hines*, 253 U.S. at 69; *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 221-222 (1897); *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185, 219-224 (1897). However, under New Jersey's broader theory—that the unitary business principle should be eliminated entirely—every operation commonly owned would be treated, for state taxation purposes, as a single unitary business regardless of its relationship to the in-state activities.

The "unitary" concept arose in the late 19th century as a method for valuing transportation and communication systems that traversed state boundaries. The Court recognized that a state could assess a tax by valuing the entire property as a unit and, through application of a formula, determine the taxing state's share of that value. *See, e.g., Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 26 (1891); *Western Union Telegraph Co. v. Taggart*, 163 U.S. 1, 18 (1896). This "unit rule" accounted for the fact that through common ownership and use, the true value of the property may exceed the cost of the property itself. *See State Railroad Tax Cases*, 92 U.S. 575, 608 (1876). Thus, the value of the miles of railway track within a state is heightened when that track crosses into a second state. A failure to account for that aspect would result in undervaluing the instate miles of track. As this Court has recognized,

> The only reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess.

Wallace v. Hines, 253 U.S. at 69. At the same time this Court made clear that "[t]he purpose is not . . . to open to taxation what is not within the State. Therefore no property . . . situated [out-of-state] can be taken into account unless it can be seen in some plain and fairly intelligible way that it adds to the value of the [enterprise] and the rights exercised in the State." *Id.*

Although first applied to cases in which physical unity was manifest, the rule was soon applied where only operational, rather than physical, unity was present. *See Adams Express Co.*, 165 U.S. at 220. Although physically unconnected, the value of an express company's property in one state would not be fairly reflected without considering its operational connection to property in other states. The principle was then extended to the income tax calculations for companies operating across state lines. *See United States Glue Co. v. Oak Creek*, 247 U.S. 321, 328-329 (1918).

Translated to the modern enterprise, the unitary business is one in which corporate constituents are involved in an economically functionally-related enterprise. If a corporation's income-producing activity in one state is inextricably linked with its activities in another state, or if the businesses of separate affiliates are intertwined, there is a unitary business. The taxable income is thus apportioned to a state based on the total income produced, without regard to state lines or corporate structure. The requisite unity is, however, more than ownership. "It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business." *Adams Express Co.*, 165 U.S. at 222.

Although the unitary business principle is central to this Court's state taxation jurisprudence, New Jersey asks that it be abandoned. The unitary principle, however, ably serves its intended purpose. A state's taxing power must "bear fiscal relation to protection, opportuni-

ties and benefits given by the state." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). Simply put, the state must have given something "for which it can ask return." *Id.* New Jersey has given no insight into the benefits it provides to an out-of-state business having no connection with the State. Given the radical nature of New Jersey's request—wholesale abandonment of a central tenet of constitutional doctrine—it would be expected that New Jersey would show that the unitary system somehow prohibits it from reaching what rightfully belongs to New Jersey. New Jersey has not even suggested, much less made a showing, that the existing unitary structure has deprived it of the ability to capture income that is properly its to tax. Nor has it shown that the unitary principle is unworkable. In short, New Jersey has established no basis for overruling the unitary cases stretching back over a century, and allowing states to sweep within their taxing jurisdiction activities wholly unrelated to instate business.

This improper expansion of state power to tax is of particular concern in those states that require combined reporting.[8] Under combined reporting, the income of

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[8] A combined report is an "*accounting* method whereby each member of a group carrying on a unitary business computes its individual taxable income by taking a portion of the combined net income of the group." *Caterpillar Tractor Co. v. Department of Revenue*, 618 P.2d 1261, 1263-64 (Ore. 1980) (emphasis in original).

A number of states currently require combined reporting for unitary businesses (*see, e.g.* Arizona, California), while others provide for it under certain circumstances (*see, e.g.*, Michigan, New York). *See* 1 State Tax Guide (CCH) ¶ 10-110 at 1071-1072. Combined reporting may be required by statute, by regulation, or by directive of the taxing authority.

Unlike a combined return, a consolidated return is appropriate for corporate affiliates, all of which are taxable in the state. The separate entities of the various member corporations are disregarded, the consolidated income of the entire group is reported on a single return, and a single tax is paid on that income. Rudolph, 25 Tax L. Rev. at 197.

affiliates that are not taxable in the state are nonetheless included in the determination of an instate corporation's income. Combined reporting requires that the income of a business conducted partly within and partly without the taxing state be determined and apportioned in the same manner regardless of whether the business is conducted by one corporation or by two or more affiliated corporations.[9] If the unitary business principle were abandoned, the state could, through revision or reinterpretation of existing law, require entities engaged in separate businesses that are unrelated except for common corporate ownership to file a single combined return. The state would thus be taxing a business on the income of an affiliated entity engaged in wholly unrelated activities. And, as described below, because of the broad flexibility states currently have with respect to apportionment formulas, *see Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978), constitutional restraints on state apportionment provide little, if any, protection against states reaching extra-territorial values. This Court should not thus expand state tax jurisdiction, particularly based on the incomplete record in this case.[10]

II. OVERRULING *ASARCO* AND *WOOLWORTH* TO PERMIT NON-DOMICILIARY STATES TO REACH PASSIVE INVESTMENT INCOME WOULD BE BOTH UNWARRANTED AND DISRUPTIVE.

New Jersey, in a proposal somewhat less radical than abandoning the unitary principle, has alternatively requested that the Court modify the unitary business principle to permit it to reach the income of passive invest-

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[9] *See* Rudolph, 25 Tax L. Rev. at 197; J. Hellerstein, *State Taxation* ¶ 8.12, at 462-63 n.527 (1983).

[10] Because New Jersey had not raised this claim in any of the prior proceedings, there is an absence of a factual record on this issue, which counsels against this Court addressing it at this juncture.

ments. In so urging, it again asks that this Court overrule past decisions that have provided important limitations on state power to tax.

Historically, States have allocated rather than apportioned the income received by a unitary business from its passive investments.[11] *See Moorman Mfg. Co. v. Bair*, 437 U.S. at 272-73; *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967); *Norfolk & Western R. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317, 325 (1868). Like real property, the location of intangible property was considered determinable; therefore, so long as it did not form an "integral part[] of some local business," *Farmers Loan & Trust Co. v. Minnesota*, 280 U.S. 204, 213 (1930), such property was located at the business situs or commercial domicile, and was properly attributable in full to that state. *See Wheeling Steel Corp v. Fox*, 298 U.S. 193 (1936).

Recognizing the appropriateness of this practice, Wisconsin, in creating the modern corporate income tax, provided for apportionment of most income, but retained the allocatation of income derived from passive investments. *See* Wis. Stat. § 1087 m-1 (1911). The 1920 Model Business Income Tax Act adhered to this approach, and by 1940, most states with corporate income taxes did so as well.[12] Adhering to the long-standing practice, the majority of states today allocate passive investment income to the state of domicile,[13] and it is the specified treat-

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[11] "Allocation" refers to attributing an item of property, income, receipts, and the like to a particular state, based on tracing the source of income to that State. Hellerstein, *State Taxation* ¶ 8.4, at 328 n.95. Where a state "allocates" income, it taxes 100% of that income. In contrast, apportionment is the assignment of that portion of an enterprise's total income that is attributable to the taxing state. *See id.*

[12] *See* L. Silverstein, *Problems of Apportionment in Taxation of Multistate Business*, 4 Tax L. Rev. 207, 210 (1949).

[13] *See* Appendix to Brief of Allied-Signal on Reargument.

ment in the Uniform Division of Income for Tax Purposes Act ("UDITPA"). *See* UDITPA § 1(a) & (e).

This approach comports with longstanding constitutional doctrine developed from the unitary business cases. The Court consistently has found that the Due Process and Commerce Clauses prohibit state taxation absent a minimal connection between the interstate or international activities and the taxing state, and a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *See, e.g., Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 219-20 (1980). The unitary nature of the business supplied the nexus and rational relationship essential to apportionment. As the Court has recognized, "the linchpin of apportionability in the field of state income taxation is the unitary business principle." *Mobil Oil Corp.*, 445 U.S. at 439.

In *ASARCO Inc. v. Idaho State Tax Comm'n*, and *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, this Court made clear that the constitutional limitations preclude states from including in the taxable income of a nondomiciliary parent corporation the passive investment income of subsidiaries that have no other connection with the taxing state. The Court has subsequently reiterated that an exchange of value beyond "the mere flow of funds arising out of a passive investment" is necessary before a state may permissibly tax the out-of-state income from passive, uncontrolled investments of an otherwise unitary business. *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 166 (1983).

New Jersey's request that this longstanding approach be reversed raises several problems. To begin with, the gain or loss from passive investments is a product of managerial activities and decision-making occurring in the commercial domiciliary state, not in the state in which, for example, the nondomiciliary corporation operates a manufacturing concern. The intangibles giving rise to dividends are generally acquired, managed, and held at

the taxpayer's headquarters in the state of commercial domicile. While New Jersey may have a relationship to Bendix's organic business activities, New Jersey has not demonstrated that it provides any sort of benefit to or has any nexus with activities generating passive investment income. *See Complete Auto*, 430 U.S. at 279; *Wisconsin v. J.C. Penny Co.*, 311 U.S. at 443.[14]

Additionally, as a practical matter, permitting nondomiciliary states to tax passive investment income will not alleviate any of the complexities that may be encountered in determining taxable income and will, in fact, increase the risk of multiple taxation. States that currently allocate passive investment income of domiciliaries are likely to continue to do so.[15] At the same time, other states could well seek to apportion the identical income.

Finally, New Jersey has not indicated how states would determine their aliquot share of passive investment income. It would, of course, be necessary to determine the proper portion attributable to the unitary business (and the state's share of that amount) and how much instead should be attributed to other entities. But the traditional three-factor apportionment formulation, which is based on the proportion of a unitary business' total payroll, property, and gross receipts located in the taxing state, does not bear any sort of rational relationship to the out-of-state values of intangible income. That formula, widely used today for apportioning the tangible business income

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[14] The principle of *ASARCO* and *Woolworth* is not designed to protect from apportionment income that is functionally related to an enterprise, but instead income from passive investments. *See Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 180 n.19 (1983). *Cf. Corn Products Refining Co. v. Commissioner of Internal Revenue*, 350 U.S. 46 (1955).

[15] At the very least, the outcome requested by New Jersey would require the revision of statutes in each state that has adopted UDITPA's distinction between business and nonbusiness (passive) income.

of unitary enterprises, was designed to measure the income arising from tangibles and to "reflect a very large share of the activities by which value is generated." *Container Corp.*, 463 U.S. at 183.

The theory underlying the three-factor formula, and indeed, the basis for its acceptability for Commerce Clause purposes, is that a dollar of payroll or property or a dollar of sales made in one state, produces roughly the same amount of taxable income as a dollar in another state.[16] But this theory makes clear that the factors have virtually no relevance to dividends or to capital gains derived from the sale of stock in an unrelated business.[17] Little of the taxpayer's payroll is required, for example, to collect dividends, nor is there any reason to believe that investment income is related to the states in which goods are sold in the taxpayer's regular course of business operations. Similarly, the amount of tangible property located in the state of manufacturing has no relevance to investment decisions made at corporate headquarters located in a different state.

Overruling *ASARCO* and *Woolworth* would require the Court to reexamine an unbroken line of cases holding that, to meet the constitutional standards, a tax must be "applied to an activity with a substantial nexus with the taxing state." *Complete Auto*, 430 U.S. at 279. It could also create new problems in state taxation, as states with no connection to an out-of-state activity may nonetheless try to reach that activity's income, leading inevitably to multiple taxation and apportionment complications. New Jersey has provided no basis for disrupting the current scheme. Under these circumstances, *ASARCO* and *Woolworth* should be retained.

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[16] *See* J. Hellerstein & W. Hellerstein, *State and Local Taxation* 577 (5th ed. 1988).

[17] The drafter of UDITPA has acknowledged that the allocation and apportionment sections of the uniform act are "a formula designed for manufacturing and merchandising businesses." W. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 749 (1957).

III. THE COURT SHOULD MAINTAIN STABILITY IN THE AREA OF STATE TAXATION.

The Court has asked whether *ASARCO* and *Woolworth* should be overruled,[18] but the plain fact is that far more is at stake. As noted above, *supra* pp. 5-6, New Jersey's proposal to have this Court abandon the unitary business principle would undermine decades of settled constitutional precedent. Even New Jersey's narrower effort to allow states to apportion passive investment income would force this Court to reassess its settled principles. Under the doctrine of *stare decisis*, a party seeking to have this Court overrule precedent must provide "special justification" [19] for that extraordinary step, and that is sorely lacking in this case.

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[18] *See* Order in No. 91-615 (March 11, 1992) ("Order").

[19] *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984). "[*S*]*tare decisis* is a basic self-governing principle within the Judicial Branch, which is entrusted with the sensitive and difficult task of fashioning and preserving a jurisprudential system that is not based upon 'an arbitrary discretion.'" *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989) (quoting The Federalist, No. 78, at 490 (A. Hamilton) (H. Lodge ed. 1888)). *See also Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991); *Welch v. Texas Dep't of Highways and Public Transportation*, 483 U.S. 468, 494 (1987) ("the doctrine of *stare decisis* is of fundamental importance to the rule of law"). While *stare decisis* has almost invincible force in statutory cases (*Monell v. Department of Social Services*, 436 U.S. 658, 695 (1978)), in constitutional cases as well, "[t]here is a strong public interest in stability, and in the orderly conduct of our affairs, that is served by a consistent course of constitutional adjudication." *Thornburgh v. American College of Obstetricians and Gynecologists*, 476 U.S. 747, 780-81 (1986) (Stevens, J., concurring). Thus, in constitutional cases, special justification is required before this Court will overrule precedent. *See Rumsey*, 467 U.S. at 212; *City of Akron v. Akron Center for Reproductive Health, Inc.*, 462 U.S. 416, 419-20 (1983).

A. Considerations of *Stare Decisis* Counsel Adherence to this Court's Decisions.

In determining whether to break with past decisions, this Court has utilized a variety of considerations, each of which suggest that *ASARCO* and *Woolworth* should be reaffirmed. *ASARCO* and *Woolworth* were decided not through incomplete analysis, but after extensive briefing both by the parties themselves and *amici* representing different perspectives on the issues. *Cf., e.g., Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 766 (1984). Neither the law nor the factual context has changed in the decade since those decisions were rendered: this Court invoked *ASARCO* and *Woolworth* a year later in *Container* and has not given any indication that the unitary business principle, as applied in those decisions, no longer limits state taxation consistent with Due Process. *Cf., e.g., Goodman v. Lukens Steel Co.*, 482 U.S. 656, 659-62 (1987); *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989). Thus, this Court should not lightly upset this area of the law. A number of additional considerations suggest that *stare decisis* interests have particular weight in this case.

First, the sheer magnitude of New Jersey's proposed change counsels particular caution. New Jersey's suggestion that this Court abandon the unitary business principle would put in question literally dozens of this Court's precedents, all of which were grounded on the fact that a state may include out-of-state values in its computation of tax only when they are related to a unitary business that is carried on in the taxing state. *See, e.g., Exxon*, 447 U.S. at 219-220.

Even if the Court were to accept New Jersey's narrower proposition and hold that passive investment income is apportionable, the change would be profound. In addition to overruling *ASARCO* and *Woolworth*, the Court would also have to resolve the inconsistency of its new holding with decisions—especially *Mobil* and *Exxon*

—that preceded and forecast the *ASARCO* and *Woolworth* holdings. *See ASARCO*, 458 U.S. at 315 (noting reliance on *Mobil*); *Woolworth*, 458 U.S. at 362 (noting reliance on *Mobil* and *Exxon*).[20]

Second, it is hardly surprising that businesses have planned their tax and economic affairs according to the unitary business principle, filing their tax returns in various jurisdictions in reliance on this Court's settled law. Reliance interests always require this Court to reassess precedents with caution,[21] but stability and predictability are especially important for business decisionmaking. "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved . . . ." *Payne v. Tennessee*, 111 S. Ct. 2597, 2610 (1991).[22] Businesses

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[20] In addition, most states would have to rework their taxation schemes which, modeled after UDITPA, rest on the distinction between business and nonbusiness income. *See supra* p. 10.

[21] *See, e.g., Monell v. Department of Social Services*, 436 U.S. at 700.

[22] The core of *stare decisis* is that the principle furthers "the stability and predictability required for the ordering of human affairs over the course of time." *Williams v. Florida*, 399 U.S. 78, 127 (1970) (Harlan, J., concurring in part and dissenting in part). *Stare decisis* ensures that "the law will not merely change erratically," and "permits society to presume that bedrock principles are founded in the law rather than in the proclivities of individuals." *Vasquez v. Hillery*, 474 U.S. 254, 265 (1986). It "embodies an important social policy. It represents an element of continuity in law, and is rooted in the psychologic need to satisfy reasonable expectations." *Helvering v. Hallock*, 309 U.S. 106, 119 (1940). Among the "weighty considerations" that "underlie the principle that courts should not lightly overrule past decisions," most important is enabling individuals "to plan their affairs with assurance against untoward surprise . . . ." *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375, 403 (1970). "When rights have been created or modified in reliance on established rules of law, the arguments against their change have special force." *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980).

carefully tailor their operations to this Court's decisions.[23] Where businesses have justifiably relied on precedent, overruling severely disrupts business planning and operation. Businesses have relied on *ASARCO* and *Woolworth* for a decade, and those reliance interests would be frustrated by this Court's overruling. *Cf., e.g., Monell v. Department of Social Services*, 436 U.S. 658, 700 (1978). Thus, as this Court has noted:

> Judicial decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons, certainly not because of subsequent doubts as to their soundness. The prosperity of a commercial community depends, in a great degree, upon the stability of the rules by which its transactions are governed.[24]

Maintaining stability in this area is particularly appropriate because any change would affect the tax consequences of past conduct.[25] Businesses have filed their tax returns in reliance on the unitary business principle generally, and on the Court's holdings in *ASARCO* and *Woolworth* that passive investment income that is unrelated to a company's unitary business in a taxing jurisdiction may not be apportioned by that state. Any change in this area

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[23] *See, e.g.*, W. Knepper, *Liability of Corporate Officers and Directors* § 14.02 at 418 (3d ed. 1978); J. Ayre, *Corporate Legal Departments: Strategies for the 1980s* 93 (1984).

[24] *National Bank v. Whitney*, 103 U.S. 99, 102 (1880). *See also, e.g., Walling v. Halliburton Oil Well Cementing Co.*, 331 U.S. 17, 25-26 (1947) (because of continued recognition of the precedent by the Court, Congressional acquiescence in the decision, and reliance by business, the Court notes that "[e]ven if we doubted the wisdom of [the precedent] as an original proposition, we should not be inclined to depart from it at this time").

[25] "Because it forces us to consider the disruption that our new decisional rules cause, retroactivity combines with *stare decisis* to prevent us from altering the law each time the opportunity presents itself." *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439, 2450 (1991) (Blackmun, Marshall, and Scalia, JJ., concurring in the judgment).

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

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TABLE OF CONTENTS

	Page
INTEREST OF THE AMICI CURIAE	1
SUMMARY OF ARGUMENT	2
ARGUMENT	6
I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED	6
A. *ASARCO* and *Woolworth* Are Solidly Grounded in Long-Established Principles of State Tax Jurisprudence	6
1. The Unitary Business Principle Derives from Due Process and Commerce Clause Prohibitions Against Extraterritorial Taxation	7
2. The Court's Treatment of Intangible Income in *Mobil*, *ASARCO*, and *Woolworth* Follows Inexorably from the Unitary Business Principle	9
B. Abandoning the Unitary Business Principle Would Pose Significant Constitutional and Practical Difficulties	11
1. Apportionment of Intangible Income from Non-Unitary Investment Would Require Wholesale Revisions and Judicial Reassessments of State Apportionment Formulas	12
2. Rejecting *ASARCO* and *Woolworth*'s Treatment of Intangible Income Necessarily Comprehends Rejecting Unitary Taxation Principles for Operational Income as Well	14
3. Abandoning Unitary Taxation Will Create Obstacles to a State's Ability to Tax Income Earned Within Its Borders	17

TABLE OF CONTENTS—Continued

Page

4. Any Significant Departure from the Unitary Business Principle Should Come from Congress, Not from This Court 22

II. A DECISION OVERRULING *ASARCO* AND *WOOLWORTH* SHOULD APPLY ONLY PROSPECTIVELY 27

CONCLUSION 30

TABLE OF AUTHORITIES

CASES — Page

ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) ..... *passim*
Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 9, 15
American Trucking Ass'ns v. Smith, 110 S. Ct. 2323 (1990) 27, 28
Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) 7
Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) 8
Braniff Airways, Inc. v. Nebraska State Bd. of Equalization & Assessment, 347 U.S. 590 (1954) 17
Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573 (1986) 7
Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932) 23
Butler Bros. v. McColgan, 315 U.S. 501 (1942) 8, 15
Central Railroad Co. v. Pennsylvania, 370 U.S. 607 (1962) 17, 24
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 5, 27, 28
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) ..... *passim*
Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980) 8, 14, 16
F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982) ..... *passim*
James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991) 27, 29
Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) 18, 20
M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) 26
McCarroll v. Dixie Greyhound Lines, Inc., 309 U.S. 176 (1940) 23
McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 110 S. Ct. 2238 (1990) 28
Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869 (1985) 25

TABLE OF AUTHORITIES—Continued

	Page
Milwaukee County Pavers Ass'n v. Fiedler, 922 F.2d 419 (7th Cir.), *cert. denied*, 111 S. Ct. 2261 (1991)	26
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)	*passim*
Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978)	13
National Bank v. Whitney, 103 U.S. 99 (1880)	23
Northwest Airlines, Inc. v. Minnesota, 322 U.S. 292 (1944)	23
Payne v. Tennessee, 111 S. Ct. 2597 (1991)	22
Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946)	5, 25, 26
Standard Oil Co. v. Peck, 342 U.S. 382 (1952)	4, 17
State Railroad Tax Cases, 92 U.S. 575 (1875)	8
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920)	8
Union Refrigerator Transit Co. v. Kentucky, 199 U.S. 194 (1905)	24
United States v. Goodyear Tire & Rubber Co., 110 S. Ct. 462 (1989)	15
Wallace v. Hines, 253 U.S. 66 (1920)	9
Walters v. National Ass'n of Radiation Survivors, 473 U.S. 305, 318-19 (1985)	26
Western & Southern Life Ins. Co. v. State Board of Equalization, 451 U.S. 648 (1981)	24
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)	7
STATUTES	
McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015	25
N.J. Stat. Ann. §§ 54:10A-4(k), 54:10A-5(c)	16
Uniform Division of Income Tax Purposes Act, 7A U.L.A. 331 (1985)	9, 12
MISCELLANEOUS	
Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387 (1983)	25, 26
Developments in the Law—Federal Limitations on State Taxation of Interstate Business, 75 Harv. L. Rev. 953 (1962)	9

TABLE OF AUTHORITIES—Continued

Page

Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993 (1986) 25

J. Hellerstein & W. Hellerstein, *State and Local Taxation* (4th ed. 1978) 9

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INTEREST OF THE AMICI CURIAE

The amici curiae are multijurisdictional corporations that do business in, and are subject to taxation by, many states. Each receives various forms of investment income derived from its ownership of intangible property—including income from dividends, royalties, interest, and

capital gains. The amici therefore have a strong interest in the constitutional principles governing state taxation of intangible and other forms of income earned by multistate businesses. A decision overruling *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 344 (1982), would substantially alter those principles and would significantly affect both the tax liabilities of the amici and the environment in which they conduct their business.

Counsel for the parties have consented to the filing of this brief in letters filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

I. A. *ASARCO* and *Woolworth* are an integral part of a longstanding and coherent constitutional structure for the taxation of multistate corporations. A state may tax income only to the extent that it provides benefits and protection to the activities that generate the income. For a functionally integrated enterprise operating in different jurisdictions, states comport with that basic territorial limitation by accumulating all the income of the enterprise and taxing an apportioned share fairly reflecting the enterprise's in-state activities. But where a company earns income through a non-unitary "discrete business enterprise," a state that has no connection with the activities of that separate enterprise has no authority to tax the income it generates; its connection with the company alone is not enough. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439-40 (1980). This "unitary-business principle" is the "linchpin" of the apportionment system. *Id.* at 439.

Mobil, *ASARCO*, and *Woolworth* faithfully apply the unitary business principle to the taxation of intangible income. Dividends are apportionable only if the payor's income-earning activities outside the state are integrally related to the recipient's business activities inside the

state. Overruling these cases would create major dislocations in settled law and yield an inferior system fraught with difficulties.

B. 1. Including in the apportionable base intangible income arising from non-unitary economic activity would add vast sums that bear no relation to the traditional operational apportionment factors—payroll, property, and sales. Fair apportionment of such non-operational income would require major readjustment of existing formulas. States would likely adopt conflicting approaches tailored to maximize their own tax revenues from out-of-state taxpayers, with the practical consequence that multistate businesses, unlike purely local businesses, would be subject to taxation on more than 100% of their income. While the Court has said that the Commerce Clause tolerates *some* risk of multiple taxation from differing state apportionment formulas, the risk may be greatly magnified if significant new sums of passive intangible income are added to the apportionable base. At a minimum, the courts are likely to become embroiled in constitutional evaluation of redesigned apportionment formulas.

2. Abandoning the unitary business principle for intangible income necessarily entails jettisoning that principle for ordinary operational income as well. Under present law, where a company conducts two discrete businesses in different states through unincorporated divisions, each state can tax only the business with which it has a connection. But that rule is untenable if a state can tax dividend income received from a non-unitary subsidiary, because that would create a senseless distinction based on corporate form that has nothing to do with the rationale for the state's exercise of its taxing power. Thus, the logical consequence of New Jersey's argument is completely to eliminate the "linchpin" unitary business principle from the state taxation structure.

3. Overruling *ASARCO* and *Woolworth* would have the effect of substantially restricting state taxing au-

tonomy. Because of Commerce Clause constraints, *permitting* states to tax a company's income earned from its discrete, non-unitary operations requires *prohibiting* other states from fully taxing those discrete enterprises that operate within their borders. Two incompatible theories of taxation cannot coexist when one allows a state to tax income in full while the other permits a different state to tax an apportioned share of the same income. That situation would inevitably yield multiple taxation in violation of the Commerce Clause. *See Mobil*, 445 U.S. at 445-46; *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952).

This principle is fully applicable here. If New Jersey can invoke a common ownership theory to tax an apportioned share of the income from a business that operates discrete divisions in other states, without regard to whether the underlying economic activities are functionally related, it follows that other states will have to tax under the same theory as New Jersey. They would no longer be free to tax a discrete business by itself, but would have to limit themselves to an apportioned share of its income, taking into account other non-unitary businesses under common ownership. This change in the law would directly harm states in which relatively profitable discrete businesses operate. It would also reduce the rationality of the system by drawing tax revenues away from the states where the value being taxed was earned.

4. Considerations of *stare decisis* militate strongly against overruling *ASARCO* and *Woolworth*. Companies have organized their affairs, and states have drafted their statutes, with heavy reliance on the existing unitary business framework. Abandoning that principle would require legislatures in dozens of states to reconfigure their schemes for taxing the income of multistate taxpayers. Even if some change is needed, Congress's ability to study problems and fine-tune solutions makes it far better equipped than the judiciary to tackle the essentially legislative task of constructing a new system of multistate

taxation. To the extent the nexus limitations imposed by current law rest on the Commerce Clause, it is clear that Congress can intervene. Even if those restrictions are an element of due process, Congress may well have authority to legislate because Fourteenth Amendment territorial limitations apply only to the states and are not "designed to forbid action altogether by any power or combination of powers in our governmental system." *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 434-35 (1946).

II. If the Court were to overrule *ASARCO* and *Woolworth*, this would be a powerful case for prospectivity under the traditional analysis of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). The change in the law would overturn settled expectations, and retroactive effect would thwart, not promote, underlying constitutional policies. Retroactivity would also create a substantial risk of multiple taxation. Companies suddenly subjected to new taxation of intangible income on an apportioned basis might be unable, because of differing statutes of limitation, to obtain a refund from a state that had fully taxed that income on an allocation theory. The converse situation could unfairly harm states.

ARGUMENT

I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED

A. *ASARCO* and *Woolworth* Are Solidly Grounded in Long-Established Principles of State Tax Jurisprudence

In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), this Court distilled from numerous prior decisions a straightforward principle now considered axiomatic: "the linchpin of apportionability in the field of state income taxation is the unitary-business principle." The Court there permitted a non-domiciliary state to tax an apportioned share of Mobil's dividend income because the payor's out-of-state activities were integrally related to Mobil's in-state activities. The Court recognized, however, that the result might be different "[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, . . . because there would be no underlying unitary business." *Id.* at 442. That was the situation in *ASARCO* and *Woolworth*, where the Court held, true to its statement in *Mobil*, that a non-domiciliary state may not apportion dividends, interest, and capital gains income from investments in non-unitary subsidiaries.

New Jersey has now invited the Court to repudiate the previously settled unitary business principle, to overrule *ASARCO* and *Woolworth*, and to substitute a rule under which a state may tax an apportioned share of all income (or at least all investment income) regardless of whether the economic activities generating that income have any connection at all to the taxpayer's in-state business activities. But the unitary business principle derives inexorably from fundamental constitutional limitations on state taxing power and cannot casually be tossed aside. Abandoning that principle would require dismantling decades of this Court's state tax jurisprudence, drastically reallocating state tax revenues, and disturbing the settled ex-

pectations on which multistate businesses have long relied in structuring themselves.

1. *The Unitary Business Principle Derives from Due Process and Commerce Clause Prohibitions Against Extraterritorial Taxation*

The unitary business principle's analytical wellspring is this fundamental precept: "Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.' " *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) (quoting *ASARCO*, 458 U.S. at 315). A state is entitled to tax only to the extent that it provides "protection, opportunity and benefits . . . for which it can ask return." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). Income generated by out-of-state economic activities, if unconnected to any in-state activities, has no relationship to the benefits provided by the state and therefore lies beyond its permissible reach.

The rule is not unique to state taxing authority. The Court has long held under the Commerce Clause that a state "has no power to project its legislation into" other states by effectively regulating conduct that occurs there. *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935) (milk price regulation). A statute with such "extraterritorial effects," even if "addressed" only to in-state conduct, is invalid if "the 'practical effect' of the law is to control [conduct] in other States." *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573, 580-83 (1986) (liquor price affirmation statute).

While a state cannot lawfully control what is *outside* its borders, it has ample authority to tax or regulate what is *inside* its borders. And when something is partly within and partly without, the state naturally has room to determine reasonably the portion properly within its jurisdictional reach. Thus, in the context of income taxa-

tion, where a functionally integrated enterprise conducts its income-generating activities in several different jurisdictions, a state may calculate the "locally taxable income" by the apportionment method—accumulating the income of the multistate enterprise and apportioning to itself a share of the total based on a fair assessment of the state's relative contribution to the enterprise's success. *Container*, 463 U.S. at 164, 165. Because "[t]he net income of an organic, unitary business . . . is indivisible" (*ASARCO*, 458 U.S. at 333 n.1 (O'Connor, J., dissenting)), apportionment is considered a more accurate mechanism than separate geographical accounting for determining where the income of the business is truly earned and therefore the extent to which various states contribute to the income. *See, e.g., Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 218 (1980); *Butler Bros. v. McColgan*, 315 U.S. 501, 506-09 (1942); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924).

This unitary business principle, however, permits a state to include in the apportionable tax base income from out-of-state activities only if those activities have contributed—either operationally or through the creation of economies of scale or similar economic benefits—to "a unitary stream of income." *Exxon*, 447 U.S. at 226. Where the in-state and out-of-state activities are "discrete business enterprise[s]" (*Mobil*, 445 U.S. at 439), the rationale for formula apportionment breaks down because the income does not make a logically indivisible contribution to the profitability of a single business. The out-of-state income is not relevant to determining "the net profits earned within the State." *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120 (1920).

This fundamental distinction has its source in the century-old "unit rule" for apportioning state property, capital stock, and other taxes imposed on interstate railroads, express and telegraph companies, and similar enterprises. *See, e.g., State Railroad Tax Cases*, 92 U.S. 575, 608 (1875). The rule provides that, where a "unity

of use and management" connects the multistate activities of an enterprise, it may be taxed as a unit—even when "it may not be a physical unity." *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 222 (1897). But it has always been clear that "something more than a mere unity of ownership" is required in order to justify apportionment. *Id.* Out-of-state income is includable in the apportionment base only where it "can be seen in some plain and fairly intelligible way that it adds to the value of the [property] and the rights exercised in the State"; otherwise, apportionment would "open to taxation what is not within the State." *Wallace v. Hines*, 253 U.S. 66, 69 (1920).

2. *The Court's Treatment of Intangible Income in* Mobil, ASARCO, *and* Woolworth *Follows Inexorably from the Unitary Business Principle*

States have long used apportionment methods to tax multistate *business* income. But most *non-business* income, "such as rentals and capital gains from real and tangible personal property, dividends and interest from investments, royalties from patents or copyrights, and income from personal services," traditionally has been "thought to be specifically allocable to a particular activity rather than to grow out of the general business of the taxpayer." *Developments in the Law—Federal Limitations on State Taxation of Interstate Business*, 75 Harv. L. Rev. 953, 1010-11 (1962). Non-business income therefore has been taxed by allocating it to a particular jurisdiction. *Id.* For example, income from rents and royalties is allocated to the state where the underlying property is situated. *See* J. Hellerstein & W. Hellerstein, *State and Local Taxation* 399, 490-91 (4th ed. 1978). Income from intangible property is allocated to the taxpayer's commercial domicile (*e.g.*, interest and dividend income) or to the state in which the intangible is used (*e.g.*, income from patents and copyrights). *See* Uniform Division of Income for Tax Purposes Act ("UDITPA") §§ 7, 8, 7A U.L.A. 331 (1985).

In *Mobil*, the Court held that the traditional allocation approach to intangible income must bend in the face of the unitary business principle. The Court explained that, "so long as the intrastate and extrastate activities" that gave rise to the income "formed part of a single unitary business," there was no justification for excepting dividend income from the "general principle of apportionability" applicable to operating income. 445 U.S. at 437, 438. The Court emphasized, however, that "[o]ne must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." *Id.* at 440. Thus, the inquiry is whether the "operations of [the taxpayer's] subsidiaries and affiliates are distinct in any business or economic sense from its [business] activities in [the taxing state]" or whether the "dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise." *Id.* at 439, 440.

In *ASARCO* and *Woolworth*, the Court applied the legal principles synthesized in *Mobil* but ruled that the facts did not demonstrate a unitary business. 458 U.S. at 319. In *ASARCO*, the Court concluded that one of the dividend payors was "insufficiently connected" to the taxpayer's in-state activities and that the other dividend payors were "operate[d] entirely independently of" the taxpayer. *Id.* at 322, 323. In *Woolworth*, the Court found that "there [was] little or no integration of the business activities or centralization of management" linking the out-of-state subsidiaries with the taxpayer. 458 U.S. at 369.

While there is room to debate the Court's application of the legal principles to the facts of those cases, the legal principles themselves are rooted in the traditional unitary business concept. Indeed, the taxing states in those cases, like New Jersey here, had to acknowledge that they could not prevail unless the Court agreed to "expand the concept" so that "corporate *purpose*" or the economic bene-

fit of common ownership alone would justify apportionment. 458 U.S. at 325, 326 (emphasis in original); 458 U.S. at 363. But that approach, as the Court rightfully recognized, would tear the unitary business principle from its moorings in the prohibition against extraterritorial taxation. As the Court subsequently reiterated in *Container*, the essential focus remains on the extent to which the underlying income-generating activities are connected with the business conducted in the taxing state; the "mere flow of funds arising out of a passive investment or a distinct business operation" is insufficient to make "formula apportionment a reasonable method of taxation." 463 U.S. at 166.

B. Abandoning the Unitary Business Principle Would Pose Significant Constitutional and Practical Difficulties

In an area of the law where business planning puts a premium on certainty, the principles underlying *ASARCO* and *Woolworth* have become part of the legal landscape within which multistate corporations and state taxing authorities operate. With UDITPA providing guidance, the unitary business principle is now woven into the fabric of state tax statutes; abandoning that principle will require almost every state to take legislative action to revamp its tax laws. The present structure has proven to be workable, and it should be retained unless there exists a clearly superior substitute. That is not the case. Indeed, the proposal for replacing *ASARCO* and *Woolworth* is demonstrably *inferior*. It would raise a host of new issues for litigation and would ultimately create intractable difficulties in achieving a fair and rational system for taxation of multistate corporations.

1. *Apportionment of Intangible Income from Non-Unitary Investment Would Require Wholesale Revisions and Judicial Reassessments of State Apportionment Formulas*

To pass constitutional muster, "the factor or factors used in [an] apportionment formula must actually reflect a reasonable sense of how income is generated." *Container*, 463 U.S. at 168. Most states, including New Jersey, apportion income in accordance with the familiar three-factor formula, representing the unitary business's in-state ratios of payroll, property, and sales. That apportionment mechanism has been approved because "payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." *Id.* at 183.

The three-factor formula and its variations, however, reflect *operational* activities of a business and are designed to apportion *operational* income. That is so because the apportionable income base traditionally has been composed of income arising from transactions and activities conducted in the regular course of an active trade or business. *See, e.g.*, UDITPA §§ 1(a), (4). If the apportionable income base were significantly expanded to include large amounts of passive investment income from a taxpayer's holdings in discrete business enterprises, the traditional apportionment formulas would require concomitant adjustments to reflect reasonably the way such *non*-operational intangible income is generated. As Justice Stevens observed in his dissenting opinion in *Mobil*, "it is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income." 445 U.S. at 459. *See also Container*, 463 U.S. at 168 n.5.

Permitting apportionment of non-unitary passive investment income will therefore impose on states the obli-

gation to restructure their existing formulas. There is every reason to anticipate that they will adopt a crazy-quilt of conflicting solutions because there is no generally accepted method for apportioning such diverse kinds of intangible income as dividends, capital gains, and interest. The differences that emerge will not be random; rather, they may well arise from conscious decisions by individual states to maximize their own revenues from out-of-state taxpayers. The practical consequence is that companies operating in several states, unlike companies operating exclusively within one state, will be exposed to taxation on more than 100% of their income.

In approving Iowa's use of a single-factor sales formula to apportion operational income, the Court determined that the Commerce Clause tolerates, as the price of federalism, "some risk of duplicative taxation" occasioned by inconsistent apportionment mechanisms. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278 (1978). But if states are allowed to include in the apportionable tax base intangible income received from a non-unitary source, that risk will be greatly magnified—both because the fresh proliferation of more complex apportionment formulas will increase inconsistencies and because much more income will be funneled into the apportionable base. At some point, the multiple taxation that would inevitably result would so seriously threaten core Commerce Clause values—by imposing on interstate businesses duplicative tax liabilities from which intrastate enterprises are immune—that the limits of constitutional tolerance would surely be tested. At a minimum, the courts would almost certainly become embroiled in a whole new species of state tax litigation addressing the reformulated apportionment mechanisms and perhaps calling for heightened scrutiny of differing formulas to minimize the resulting interference with free interstate trade.

2. *Rejecting* ASARCO *and* Woolworth's *Treatment of Intangible Income Necessarily Comprehends Rejecting Unitary Taxation Principles for Operational Income As Well*

The problems with New Jersey's position go well beyond the difficulties it would pose in dealing with intangible income. This is so because the logical consequence of jettisoning the unitary/non-unitary distinction for intangible income is similarly abandoning the distinction for ordinary operational income. Otherwise, the taxing power of states over income generated by out-of-state economic activity, and the attendant division of tax revenues among the states, will vary substantially, but irrationally, depending on the corporate form chosen by the parent.

This problem is best illustrated by way of a simple example, similar to the one considered by the Court at oral argument in this case. Suppose a company, resident in Delaware, operates a beauty parlor business in New Jersey. It also operates a parking lot business in California. The latter is a "discrete business enterprise" (*Exxon*, 447 U.S. at 224; *Mobil*, 445 U.S. at 439) having nothing to do with the activities of the beauty parlor business.

If the businesses were structured as a parent corporation directly operating beauty parlors and also owning a California parking lot subsidiary, income from the parking lots would flow to the parent in the form of dividends. Contrary to *ASARCO*, New Jersey argues that it should be accorded the right to tax an apportioned share of those dividends as intangible income to the parent, with whom New Jersey has nexus because of the parent's beauty parlor business.

If we suppose instead that the businesses operate not through separate corporations, but rather through two divisions of the single corporation headquartered in Delaware, there would be no dividends or other intangible income. The parking lot business would earn the same income, but it would flow directly into the coffers of the

single corporation. Could New Jersey tax an apportioned share of that income?

The answer under current law is clearly no. That was precisely the issue presented in *Exxon*. The Court rejected Exxon's contention that its functional departments were "discrete business enterprises," concluding instead that they were all part of one "unitary business." 447 U.S. at 224. Based on that conclusion, it upheld Wisconsin's right to tax income from departments that did not do business in the state. But the case obviously began with the agreed legal premise that Wisconsin could *not* tax such income if the departments were not part of Exxon's unitary business. Otherwise, it would have been unnecessary to make the factual inquiry into unitariness. *See also, e.g., Butler Bros. v. McColgan*, 315 U.S. 501, 506-09 (1942); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 222 (1897).

But this settled result cannot logically coexist with New Jersey's proposed overruling of *ASARCO*. It is irrational for New Jersey's power to tax income from the parking lot business to vary depending upon whether the company operates the business through a division or a separate corporate entity that pays dividends. *See United States v. Goodyear Tire & Rubber Co.*, 110 S. Ct. 462, 467-68 (1989) (foreign tax credit rules tailored to eliminate unnecessary differences in tax treatment that depend on whether company operates through subsidiary or division). In either case, the economic activity that generates the income is the same. And the difference in corporate form has no apparent relationship to any justification for the exercise of the state's taxing jurisdiction.

In the state tax context involved here, this Court has already definitively rejected such a distinction in treatment based on corporate form. The Court observed in *Mobil* that "[o]ne must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." 445 U.S. at 440. Whether

run directly or through a subsidiary, the underlying activity is operating parking lots in California, and New Jersey's power to apportion income from that business should be the same in both cases. The Court held to that effect in *Mobil*: "Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives." 445 U.S. at 441.

This principle is equally applicable when the economic realities are that the business in question is non-unitary. If New Jersey's connection to the parent corporation gives it the power to tax non-unitary parking lot income when returned to a parent as a dividend, New Jersey should be able to tax the same parking lot income when it is earned directly by the parent. There is surely no constitutional justification for drawing any distinction. The nexus relied upon by New Jersey is the same in both instances—namely, the fact that the beauty parlor business operates in New Jersey.

In sum, New Jersey's argument that it can tax all intangible income of a company that does business there, whatever the source of the income, necessarily extends to the company's business income. Indeed, New Jersey has no doubt on this score. Counsel for the state explicitly acknowledged at oral argument that its approach would essentially eliminate the unitary business concept (Tr. 31-33, 39-40); all of a corporation's income would be regarded as "unitary" by definition. And New Jersey's income tax statute draws no distinction between tangible and intangible income. *See* N.J. Stat. Ann. §§ 54:10A-4 (k), 54:10A-5(c). New Jersey thus proposes to scrap—for both tangible and intangible income—what this Court has repeatedly described as "[t]he 'linchpin of apportionability' for state income taxation." *Exxon*, 447 U.S. at 223 (quoting *Mobil*, 445 U.S. at 439). Removing this "linchpin" will require the painstaking construction of a new system of apportionability, one that will be fraught

with more problems and ultimately will be less fair than the longstanding unitary business system.

3. *Abandoning Unitary Taxation Will Create Obstacles to a State's Ability to Tax Income Earned Within Its Borders*

New Jersey's request for authority to tax income earned by a non-unitary business inevitably carries with it a restriction on the authority of other states to tax income under a traditional, unitary business approach. Any new taxing power that the Court gives to New Jersey must be taken away from some other state. Otherwise, the new system that would emerge could not survive Commerce Clause scrutiny because it would yield inevitable multiple taxation of multistate corporations.

This Court has recognized for many years that permitting property taxation on the basis of apportionment is incompatible, as a matter of constitutional law, with full taxation by the state of domicile. In *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952), Ohio claimed the right to collect property tax on the full value of barges owned by an Ohio company. The Court rejected that claim because other states where the barges operated were empowered to tax the value of the barges on an apportioned basis. The Court explained (*id.* at 384-85): "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. . . . Otherwise there would be multiple taxation of interstate operations." *See also Braniff Airways, Inc. v. Nebraska State Bd. of Equalization & Assessment*, 347 U.S. 590, 601 (1954). In *Central Railroad Co. v. Pennsylvania*, 370 U.S. 607, 614 (1962), the Court reemphasized that the possibility of apportioned property taxation by other states "would render unconstitutional any domiciliary ad valorem tax at full value." *Id.*

The constitutional infirmity inherent in permitting taxation under both apportionment and allocation theories

formed the basis for this Court's holding in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). The Court there held that a state could not impose an apportioned property tax on foreign-owned instrumentalities of international commerce because that would pose an unacceptable "risk of international multiple taxation." *Id.* at 451-52. The Court explained the governing principle as follows (*id.* at 447): "The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full. . . . The basis for this Court's approval of apportioned property taxation, in other words, has been its ability to enforce full apportionment by all potential taxing bodies." Because the Court was not in a position to prevent the foreign country of domicile from taxing the full value of the property on an allocation theory, it held that the Commerce Clause prohibits a state from taxing a portion of that value on an apportionment theory. *Id.* at 447-48, 451-52.

The Commerce Clause barrier to allowing different states to use incompatible theories of taxing jurisdiction is equally present in the context of state income taxation, and the Court so held in *Mobil*. *See* 445 U.S. at 442-46. Mobil objected on multiple taxation grounds to the Court's holding that Vermont could tax a portion of the dividends received by a New York corporation so long as the dividend payor was part of the unitary business of the company doing business in Vermont. Mobil argued that this would violate the Commerce Clause because the domiciliary state was already permitted under established law to allocate 100% of those dividends to itself for unapportioned taxation (although in fact New York had not elected to tax the dividends).

This Court agreed with the basic principle of Mobil's multiple taxation argument—namely, that two distinct income taxation systems cannot be permitted to coexist if they provide for taxation of more than 100% of the taxpayer's income. "Taxation by apportionment and tax-

ation by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained." 445 U.S. at 444-45. The Court rejected Mobil's conclusion only because it believed that the conflict should be resolved by having New York's ability to tax 100% of dividend income yield in the face of Vermont's right to tax an apportioned share of the dividends. The Court ruled that, although the state of domicile is authorized "to lay *some* tax on [Mobil's] dividend income . . . there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States." *Id.* at 445-46 (emphasis added).

In *Mobil*, the Commerce Clause prohibition on incompatible taxation theories affected only the unique taxing authority historically accorded to the domiciliary state over dividend income—and then only to the extent dividends are received from a unitary subsidiary. But if New Jersey's position here is upheld, the longstanding authority of all states to tax economic activity occurring within their borders will be undermined. Just as apportionment and allocation are "incommensurate" theories of taxation, so too are full taxation on a discrete enterprise theory and New Jersey's approach of apportioned taxation on a common ownership theory without regard to whether businesses are unitary. Under the present system, the state in which a discrete business enterprise is located can fully tax the income from that business, without regard to whether the enterprise shares common ownership or affiliation with some other discrete businesses located in other states. But New Jersey now claims the right to tax a portion of the income from a discrete business enterprise operating outside New Jersey—on the basis of New Jersey's connection to an affiliated (but nonunitary) enterprise that does do business in New Jersey. Upholding that claim means that double taxation will inevitably result unless the first state in which the dis-

crete business enterprise is located is required also to apportion its tax.

This serious implication of New Jersey's argument is well illustrated by the example considered by the Court at oral argument and discussed earlier—that is, where a company operates through unincorporated divisions a beauty parlor business in New Jersey and a parking lot business exclusively in California. Under current law, California would tax the discrete enterprise that operates there; because the parking lot business operates entirely in one state, California would tax 100% of the income. But if New Jersey is upheld in its claim to tax an apportioned share of the parking lot income, California cannot be permitted to continue its practice of taxing the parking lot business in full as a discrete enterprise. As this Court made clear in *Mobil*, apportioned taxation by New Jersey coupled with 100% taxation by California of the same income runs afoul of the Commerce Clause. The Court would have to exercise "its ability to enforce full apportionment by all potential taxing bodies" (*Japan Line*, 441 U.S. at 447), not just by New Jersey. Thus, as counsel for the state acknowledged at oral argument (Tr. 43-44), the inevitable consequence of New Jersey's argument that it be *permitted* to tax non-unitary business income is that other states must be *prohibited* from taxing in full the income of businesses operating exclusively within their own state.

This departure from well settled state tax law would be a step backwards from the present system in terms of fairness and rationality because it would undermine the longstanding guiding principle that income should be taxed by the state in which value was earned. In expanding the power of states to tax non-unitary business income, New Jersey's proposal would correspondingly diminish the power of states to tax discrete businesses without apportionment, thereby redistributing tax revenues away from the states that contributed their services and protections to the generation of the income. If the park-

ing lot business were profitable and the beauty parlor business were not, the change would directly reduce California's tax revenue, in effect forcing California to cede to New Jersey some of its income tax base.

The irrationality and multiple taxation potential of New Jersey's proposal is exacerbated when non-business income is thrown into the mix. Suppose in our example that, in addition to the beauty parlor and parking lot businesses, the company conducted investment activities in its home state of Delaware. This situation would be uncomplicated under current law. California would be permitted to tax 100% of the parking lot income, New Jersey would be permitted to tax 100% of the beauty parlor income, and Delaware would be permitted to tax 100% of the investment income.

Adopting New Jersey's proposal, however, would introduce substantial confusion. New Jersey presumably would seek to tax an apportioned share of all the income of the corporation, including the parking lot income and the investment income (perhaps making some factor adjustment to account for the investment activities). Delaware might still seek to tax 100% of the investment income, though under *Mobil* it presumably would be constrained by New Jersey's taxation on an apportionment theory. California also would have a claim to some portion of the investment income under New Jersey's theory that the non-business income of a company can be taxed by any state in which that company does business, no matter how discrete its operations. Indeed, New Jersey's theory presumably would allow Delaware, on the basis of the investment activity, to tax a portion of the income from the New Jersey and California operations. It would be imprudent, at best, to jettison 70 years of settled law for the purpose of introducing this kind of chaos.

Finally, abandonment of the unitary business approach could harm the public fisc by opening the door for corporate tax planners to take steps that would result in

reduction of the aggregate state tax base. If a state is prohibited from taxing on a traditional unitary basis and instead must apportion on the basis of all the taxpayer's operations, including discrete enterprises operating only in other states, the state's tax base necessarily will be affected by all changes in a company's business, even when those changes bear no relation to the business activity that the state is trying to tax. This circumstance could tempt companies to invest in businesses that operate in states that have no, or relatively light, corporate income tax.

For example, if Nevada has no corporate income tax, the company operating beauty parlors in New Jersey and parking lots in California might purchase a supermarket chain in Nevada. The new investment would bring substantial tax benefits because a supermarket would have relatively significant apportionment factors, such as a high sales volume, coupled with relatively low net income. Incorporating those factors into the company's apportionment formula would draw income from the beauty parlor and parking lot businesses into Nevada for taxation. The company would then have succeeded in reducing its total state tax bill by reducing the amount of income available for taxation by California and New Jersey and attributing that income to Nevada, where no state income tax is imposed.

4. *Any Significant Departure from the Unitary Business Principle Should Come from Congress, Not from This Court*

Even if this Court were to agree with New Jersey as a matter of first principles that intangible income should be taxable without regard to the unitary business limitation, it would be inappropriate to overturn decades of established law to implement that conclusion. "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved." *Payne v. Tennessee*, 111 S. Ct.

2597, 2610 (1991). *See also National Bank v. Whitney*, 103 U.S. 99, 102 (1880). Taxation is one area where "it is more important that the applicable rule of law be settled than that it be settled right." *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting). That is particularly true in this context where the reliance interests are so strong for both multistate businesses and states.

Businesses have organized their affairs in justified reliance on the Court's established state tax jurisprudence, making decisions such as where to locate their headquarters and whether to acquire other businesses. The states have drafted their statutes to fit into the framework of the present system. Indeed, this Court has noted that the unitary business principle "forms the basis for" UDITPA, which is the product of an effort to achieve uniformity in this difficult area and which has been adopted by about half the states. *Container*, 463 U.S. at 165. The Court should not lightly dash the expectations of these parties, require states to revamp their tax codes, and create substantial "practical dislocation" of the established framework for operating, and taxing, multistate businesses. *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292, 300 (1944).

To the extent it is necessary to consider substantial changes in the system for state taxation of multistate corporations, Congress is much better equipped to handle that task than is this Court. Congress has tools at its disposal, such as the hearing process, to study the broad scope of the issue and the full ramifications of any changes. The Court is comparatively hampered in this regard because it must deal with the complex issues on the basis of single cases that come before it for adjudication. *See Northwest Airlines*, 322 U.S. at 299-300; *McCarroll v. Dixie Greyhound Lines, Inc.*, 309 U.S. 176, 189 (1940) (Black, J., dissenting). Unlike this Court, Congress also has the power to fine-tune its changes, through mech-

anisms such as transitional rules, to minimize the adverse impact on reasonable expectations. Congress also can legislate at a level of detail unavailable to the judiciary in order to promote rationality in a new system—for example, by delineating permissible methods of apportionment. *See generally ASARCO*, 458 U.S. at 349-53 (O'Connor, J., dissenting).

There is room for the exercise of congressional authority in this area even though the unitary business principle rests on constitutional foundations. Indeed, the Court explicitly stated in *ASARCO* that it viewed the scope of congressional authority as an open question, denying the dissent's accusation that the majority had " 'strip[ped] Congress of the authority' to authorize or regulate state taxation." *See* 458 U.S. at 327 n.23. Chief Justice Burger concurred in reliance "on the Court's express statement that the Court's holdings do not preclude future congressional action in this area." *Id.* at 331.

While the Court has invoked both the Due Process Clause and the Commerce Clause in its decisions, various Justices periodically have questioned whether the Fourteenth Amendment is truly the source of the restrictions on state taxing authority embodied in *ASARCO* and its predecessors. *See ASARCO*, 458 U.S. at 350 n.14 (O'Connor, J., dissenting); *Central Railroad Co. v. Pennsylvania*, 370 U.S. at 618-22 (Black, J., concurring); *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194, 211 (1905) (opinion of Holmes, J.). To the extent those restrictions rest solely on the Commerce Clause, there is no doubt that Congress can legislate to change them. *See, e.g., Western & Southern Life Ins. Co. v. State Board of Equalization*, 451 U.S. 648, 652-53 (1981).

Moreover, even if these restrictions do inevitably reflect due process considerations, that does not necessarily prohibit Congress from taking action. A nexus limitation on state taxation imposed by the Fourteenth Amendment

does not carry with it any analogous Fifth Amendment prohibition on federal action because there are no territorial barriers to federal taxation within the United States. Since the nexus "limits are inapplicable to federal regulation," it has been argued that Congress should "be able to remove them, regardless of whether the theoretical limit on state power stems from the due process clause or from the commerce clause." Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387, 401 (1983); *see also* Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993, 1022-28 (1986).

This argument finds support in *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408 (1946), which upheld Congress's authority to override this Court's Commerce Clause decisions. The Court stated that Congress's authority was limited only by constitutional provisions "designed to forbid action altogether by any power or combination of powers in our governmental system." *Id.* at 434-35. Where there is no constitutional prohibition on Congress's freedom of action, Congress may choose to exercise its authority "alone . . . or in conjunction with coordinated action by the states." *Id.* at 434.

In *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869 (1985), Justice O'Connor argued in dissent that the rationale of *Benjamin* extended beyond its Commerce Clause setting. She maintained that a discriminatory state insurance tax could not be struck down as violative of the Equal Protection Clause if it was authorized by the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015. She explained that the federal statute would override the constitutional prohibition on state discrimination against out-of-state business because "any federalism component of equal protection is fully vindicated where Congress has explicitly validated a parochial focus." 470 U.S. at 899 (O'Connor, J., dissenting).

The full Court did not reach this issue in *Metropolitan Life* because the majority did not agree that McCarran-Ferguson authorized states to pass protectionist legislation that would violate equal protection. More recently, however, the Seventh Circuit has reached the same issue of congressional authority in a different context and has explicitly embraced the conclusion suggested by Justice O'Connor. *Milwaukee County Pavers Ass'n v. Fiedler*, 922 F.2d 419, *cert. denied*, 111 S. Ct. 2261 (1991). Analogizing to the Commerce Clause, the court held that Congress could authorize the states to engage in affirmative action programs that would otherwise be constitutionally prohibited so long as Congress itself could have implemented the programs. Congress had merely "enlisted states as its agents." *Id.* at 424.

These authorities suggest that "Congress can consent to state laws where constitutional restrictions bind the states but not Congress" (Cohen, *supra*, at 406), which would include state tax measures that offend nexus requirements embodied in the Fourteenth Amendment. Congress and the states are not "forbidden to cooperate . . . to achieve legislative consequences, particularly in the great fields of regulating commerce and taxation, which, to some extent at least, neither could accomplish in isolated exertion." *Prudential Ins. Co. v. Benjamin*, 328 U.S. at 439.[1]

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[1] In any event, even if Congress cannot override entirely a ruling rooted in the Due Process Clause, its pronouncements should, at minimum, inform this Court's consideration. Under Article I, section 8, Congress is the expert in the area of commercial relations—both interstate and foreign. As a consequence, a congressional judgment concerning the allocation of multistate business income is entitled to considerable deference. As Chief Justice Marshall stated for the Court in *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 401 (1819), "[a]n exposition of the constitution, deliberately established by legislative acts, . . . ought not to be lightly disregarded." *See also Walters v. National Ass'n of Radiation Survivors*, 473 U.S. 305, 318-19 (1985). While the Court might reach one conclusion where it is writing on a blank slate, it might come to a different one where a comprehensive federal enactment forms the backdrop.

II. A DECISION OVERRULING *ASARCO* AND *WOOLWORTH* SHOULD APPLY ONLY PROSPECTIVELY

If the Court decides to abandon the unitary business principle and to overturn *ASARCO* and *Woolworth*, the new rule should apply only prospectively to tax years commencing after the date of the decision. We recognize that the Court is divided over whether it may ever accord purely prospective effect to its rulings. *See James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). But unless a majority is prepared to embrace the rule of automatic retroactivity advanced by the concurring Justices in *Beam* (*see id.* at 2449 (Blackmun, J., concurring) and 2450 (Scalia, J., concurring)), this is among the strongest cases imaginable for pure prospectivity under the traditional three-prong test of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971).

First, a decision repudiating *ASARCO* and *Woolworth* would self-evidently "establish a new principle of law . . . by overruling clear past precedent on which litigants may have relied." 404 U.S. at 106. Far more clearly than in *American Trucking Associations v. Smith*, 110 S. Ct. 2323 (1990)—where the overruled line of authority had already been substantially eroded before it was finally discarded (*see id.* at 2331 (plurality opinion))—an overruling in this case would amount to a sudden and unexpected about-face.

Second, retroactive application of a new rule would not "further"—on the contrary, it would "retard"—the underlying constitutional policies. *Chevron*, 404 U.S. at 107. Certainty in matters of tax law is critical to an efficient national economy. Retrospective abrogation of state taxing limitations would replace certainty with volatility, would unsettle interstate markets, and would disserve Commerce Clause values. Multistate businesses would be forced to weigh the possibility that their projected returns will be reduced by unforeseeable retroactive changes in constitutional tax doctrine. If companies cannot plan their business affairs with confidence in this

Court's authoritative pronouncements concerning the outer boundaries of state taxing authority, they are at least marginally discouraged from engaging in robust interstate trade.

Nor does any policy of the Due Process Clause require retroactivity. If this Court were to conclude that the due process holdings of *ASARCO* and *Woolworth* too narrowly confine the taxing powers of non-domiciliary states, a prospective change would be sufficient to release those constraints and restore to the states whatever additional jurisdictional authority the Court believes they have. Retrospective exercise of such authority would not further any due process principle. The Clause is fully vindicated if the reach of state taxing power is correctly circumscribed; it is wholly neutral concerning whether a state in fact collects taxes to the limit of its powers. If anything, the retroactive imposition of new tax liabilities for past conduct would be abhorrent to traditional due process norms, at least insofar as it "unduly interfer[es] with settled expectations." *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238, 2252 n.23 (1990).

Third, retroactive application of a decision overruling *ASARCO* and *Woolworth* would produce "substantial inequitable results." *Chevron*, 404 U.S. at 108. Business taxpayers have structured their operations over many decades in reliance on this Court's unbroken line of constitutional decisions predicating the apportionability of income on the unitary business principle. Nothing in any of the Court's prior decisions would have alerted taxpayers to the possibility of a dramatic change in the applicable rules. When, as in this instance, affected parties "cannot be expected to foresee that a decision of this Court would overturn established precedents, the inequity of unsettling actions taken in reliance on those precedents is apparent." *American Trucking Ass'ns v. Smith*, 110 S. Ct. at 2333 (plurality opinion).

The risk of gross inequity is especially acute in the present context, because retroactive imposition of a new state taxing regime would open the door to multiple taxation. Taxpayers could well find themselves exposed to a wave of new retroactive assessments by non-domiciliary states asserting the power to tax an apportioned share of intangible income that has already been taxed in full by the domiciliary state. Because of differing statutes of limitations, however, the same taxpayers may be foreclosed from seeking refunds from the domiciliary state and could therefore wind up paying multiple state taxes on the same income. The potential competitive dislocations and financial disruptions are inestimable. Conversely, some states may be exposed to a raft of refund claims from domiciliary corporations but may be foreclosed in some cases from issuing new assessments to non-domiciliaries whose prior tax years are closed. The consequent retrospective reallocation of tax dollars among the states and tax liabilities among taxpayers would likely produce a needless flood of new litigation and significantly distort commercial marketplaces with inequitable results for all concerned.

Even if a majority of the Court were to adopt a principle of automatic retroactivity in civil cases, the equitable considerations discussed above should counsel strongly against overuling *ASARCO* and *Woolworth*. As the concurring Justices in *Beam* noted, a rule of automatic retroactivity "forces us to consider the disruption that our new decisional rules cause" and "combines with *stare decisis* to prevent us from altering the law each time the opportunity presents itself." 111 S. Ct. at 2540 (Blackmun, J., concurring). Given the potential in this case for massive economic dislocations if the Court were to " 'make new law' " (*id.* at 2451 (Scalia, J., concurring)), it should be particularly loath to take that drastic step here.

CONCLUSION

The judgment of the Supreme Court of New Jersey should be reversed.

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APRIL 1992

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

In The
SUPREME COURT OF THE UNITED STATES
October Term, 1991

ALLIED-SIGNAL INC.
as successor in interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF THE FINANCIAL INSTITUTIONS STATE TAX COALITION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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April 10, 1992

QUESTION PRESENTED

Irrespective of whether this Court overrules ASARCO, Inc. v. Idaho State Tax Comm'n., 458 U.S. 307 (1982) and F.W. Woolworth Co. v. Taxation and Revenue Dep't., 458 U.S. 354 (1982), what constitutional principles should govern state taxation of corporations doing business in several states, in order to protect corporations engaged in interstate commerce from overlapping and conflicting state taxation?

TABLE OF CONTENTS

Page

QUESTION PRESENTED FOR REVIEW i

TABLE OF AUTHORITIES iv

INTEREST OF AMICUS CURIAE 1

SUMMARY OF THE ARGUMENT 2

IRRESPECTIVE OF WHETHER ASARCO AND WOOLWORTH ARE OVERRULED, THIS COURT SHOULD HOLD THAT MULTIPLE TAXATION BY STATES IS UNCONSTITUTIONAL 3

A. THIS CASE HIGHLIGHTS THE PREVALENT RISK OF MULTIPLE STATE TAXATION OF MULTISTATE BUSINESSES 4

B. IF ASARCO AND WOOLWORTH ARE OVERRULED, DIVIDENDS AND GAINS ON SALE OF STOCK SHOULD NOT BE HELD SUBJECT TO NONDOMICILIARY STATE TAXATION OF AN APPORTIONED BASIS UNLESS SUCH INCOME CONSTITUTES BUSINESS INCOME 5

C. MULTIPLE TAXATION ARISING FROM DISCRIMINATORY APPORTIONMENT FORMULAS OF NONDOMICILIARY STATES IS UNCONSTITUTIONAL UNDER THE COMMERCE CLAUSE 7

1. Aggressive Efforts By States To Shift Tax Burdens To Nondomiciliary Businesses Highlight The Need To Overrule Moorman 7

2. Apportionment And Sourcing Rules That Look Primarily Or Solely To The Destination Of Sales And Disregard The Location Of Other Income-Producing Activities Are Unconstitutional Under The Commerce Clause 10

CONCLUSION 12

TABLE OF AUTHORITIES

Page(s)

CASES:

ASARCO, Inc. v. Idaho State Tax Comm'n.,
458 U.S. 307 (1982) . . . . . passim

Complete Auto Transit, Inc. v. Brady,
430 U.S. 274 (1977) 10

Container Corp. of America v. Franchise Tax Board,
463 U.S. 159 (1983) 6,10,11

Hans Rees' Sons v. North Carolina,
283 U.S. 123 (1931) 8

F.W. Woolworth Co. v. Taxation and Revenue Dep't.,
458 U.S. 354 (1982) i,2,5

Mobil Oil Corp. v. Comm'r of Taxes,
445 U.S. 425 (1980) 7

Moorman Manufacturing Co. v. Bair,
437 U.S. 267 (1978) . . . . . passim

Trinova Corp. v. Michigan Treasury Dept.,
111 S.Ct. 818 (1991) 11

Page(s)

STATUTES:

Ariz. Rev. Stat. Ann. §43-1139 9
Conn. Gen. Stat. §12-218 9
Fla. Stat. §220.15(4) 9
Ga. Code Ann. §48-7-31(d)(1)(B) 9
Ill. Rev. Stat. Ch. 120, §3-304(a) 9
Ind. Code §6-5.5-2-4 9
Ky. Rev. Stat. Ann. §141.120(8) 9
Me. Rev. Stat. Ann. tit. 36, §5211.8 9
Mass. Gen. L. Ch. 63, §38(c) 9
Mich. Stat. Ann. §208.45 9
Minn. Stat. §290.191.3 9
Neb. Rev. Stat. §77-2734.05 9
N.H. Rev. Stat. Ann. §77-A:3,I 9
N.H. Rev. Stat. Ann. §77-A:3,II(a) 9
Ohio Rev. Code Ann. §5733.05(B)(2) 9
Or. Rev. Stat. §314.650 9
S.C. Code Ann. §12-7-1190 9
Tenn. Code Ann. §67-4-815 9
W.Va. Code §11-24-7b(b)(4)(A) 9
Wis. Stat. §71.25(6) 9

UNIFORM LAWS:

Uniform Division of Income for Tax Purposes
Act, 7A Uniform Laws Annotated 331
(West 1985) §1(a) 3,6

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BRIEF OF THE FINANCIAL INSTITUTIONS STATE TAX COALITION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

The Financial Institutions State Tax Coalition (hereinafter the "Coalition") hereby respectfully submits this brief as amicus curiae in support of the Petitioner in the above captioned matter. The written consent of both of the parties has been obtained and filed with the Clerk of this Court.

The Coalition is an ad hoc committee comprised of a cross-section of financial institutions and financial service

providers throughout the United States[1] that are engaged in multistate financial services businesses. The Coalition was organized to promote and support equitable and nondiscriminatory state tax policies governing multistate financial institutions and financial services providers. The Coalition's members are directly affected by state taxation of interstate operations.

The Coalition respectfully submits this brief in response to the Court's invitation of amici to address constitutional principles in the event ASARCO and Woolworth are overruled. The Coalition urges this Court to enunciate constitutional principles that will protect taxpayers from the threat of multiple taxation arising from the Allied-Signal decision. These principles are of tremendous importance to the commercial banking and financial services industries.

SUMMARY OF THE ARGUMENT

If this Court overrules ASARCO and Woolworth, it should be recognized that dividends and gains from stock investments can only be taxed on an apportioned basis

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[1]The Coalition's members include: Bank of America NT&SA; The Bank of New York Company, Inc.; Capital Holding Corporation; The Chase Manhattan Bank, N.A.; Citicorp/Citibank, N.A.; Dean Witter Financial Services Group Inc.; First Chicago Corporation; First Interstate Bancorp; KeyCorp; Morgan Guaranty Trust Company of New York; NationsBank; Security Pacific Corporation; and Wachovia Corporation.

consistent with the Commerce Clause if they are business income as defined by the Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985), §1(a). This Court should further rule that no state can constitutionally allocate and tax 100 percent of such dividends and gains.

In any case, this Court should make clear that sourcing rules governing all items of business income should be consistent with the activities producing such income. In that regard, apportionment formulas that largely disregard income-producing activities (viz., capital and labor) and that focus disproportionately upon sales according to customer location are unconstitutional. Such formulas, which have become more common since Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978), discriminate against multistate business in violation of the Commerce Clause. In order to protect interstate commerce from such multiple taxation, this Court should overrule Moorman.

ARGUMENT

I. IRRESPECTIVE OF WHETHER ASARCO AND WOOLWORTH ARE OVERRULED, THIS COURT SHOULD HOLD THAT MULTIPLE TAXATION BY STATES IS UNCONSTITUTIONAL.

A. THIS CASE HIGHLIGHTS THE PREVALENT RISK OF MULTIPLE STATE TAXATION OF MULTISTATE BUSINESSES.

The Allied-Signal case is a clear example of the risk of multiple taxation borne by multistate businesses. The risk is that different states, with divergent and conflicting rules for allocating and apportioning income, will together subject the income of the business to multiple taxation. In deciding this case, this Court should protect interstate commerce from this "parochial hodgepodge of overlapping and conflicting tax levies" (ASARCO, 458 U.S. at 331 (O'Connor, J., dissenting)).

This case brings into focus the conflicts between taxing rules of the various states where a multistate taxpayer does business. If the nondomiciliary state is allowed to tax capital gain upon sale of stock as apportionable business income, what would prevent the domiciliary state from taxing all of the same gain as allocable nonbusiness income? Even if the domiciliary state taxes the capital gain as apportionable business income, what protection does a multistate business have against multiple state taxation arising from inconsistent apportionment formulas in the states where it is taxable? These conflicts would be exacerbated if the definition of

apportionable income is expanded, as New Jersey seeks to do in the present case.

Although the Coalition expresses no opinion as to whether ASARCO and Woolworth should be overruled, we urge this Court to enunciate constitutional principles to guard against multiple state taxation in any event.

B. IF ASARCO AND WOOLWORTH ARE OVERRULED, DIVIDENDS AND GAINS ON SALE OF STOCK SHOULD NOT BE HELD SUBJECT TO NONDOMICILIARY STATE TAXATION ON AN APPORTIONED BASIS UNLESS SUCH INCOME CONSTITUTES BUSINESS INCOME.

If ASARCO and Woolworth are overruled, dividends and gains (or losses) on sale of stock[2] should be taxed on an apportioned basis by nondomiciliary states that have jurisdiction over the recipient corporation, only if the

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[2]Dividends from stock and gains and losses on sale of stock should be treated consistently for this purpose. Each of these items represents a return on the investment in the stock, differing only in the timing of when income and gains or losses are realized and distributed by the underlying corporation. See ASARCO, 458 U.S. at 330.

acquisition, management, and disposition of that stock constitute integral parts of the taxpayer's regular trade or business operations.[3] This constitutional rule should apply regardless of whether the activities of the corporation that issued the stock formed part of the recipient's unitary business (provided, however, such dividend, gain or loss may otherwise be eliminated under rules applicable to combined reports of unitary groups).

If such dividends, gains or losses are treated as business income subject to apportionment, they should be sourced as receipts for purposes of the apportionment formula to the location where the taxpayer manages the stock investment. If intangible property is included in the apportionment formula, the stock should be similarly sourced for purposes of the property factor. These sourcing rules are consistent with the rationale for business income treatment and properly reflect how the income is generated. See Container Corp. of America v. Franchise Tax Board, 453 U.S. 159, 169 (1983).

In addition, no state should constitutionally be permitted to allocate and tax 100 percent of such dividends and gains that are properly taxed on an apportioned basis by

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[3]This standard is derived from §1(a) of the Uniform Division of Income for Tax Purposes Act, supra.

other states where the recipient is taxable. This rule will help to protect multistate businesses from multiple taxation of apportionable income. See Mobil Oil Corp. v. Comm'r. of Taxes of Vermont, 445 U.S. 425, 443-445 (1980). While we realize that the adoption of such a rule is contrary to dictum in Moorman, 437 U.S. at 279, for the reasons set forth below, both this dictum and the holding in Moorman merit reexamination.

C. MULTIPLE TAXATION ARISING FROM DISCRIMINATORY APPORTIONMENT FORMULAS OF NONDOMICILIARY STATES IS UNCONSTITUTIONAL UNDER THE COMMERCE CLAUSE.

1. Aggressive Efforts By States To Shift Tax Burdens To Nondomiciliary Businesses Highlight The Need To Overrule Moorman.

In Moorman, this Court upheld Iowa's use of a single-factor sales formula against constitutional challenge. The taxpayer was an Illinois manufacturer whose products were sold to customers in Iowa and other states. The taxpayer -- subject to tax in Illinois under a three-factor apportionment formula -- contended that Iowa's single-factor formula resulted in taxation of a greater portion of its income than was reasonably attributable to its business in the state.

In upholding Iowa's single-factor formula against the taxpayer's Commerce Clause challenge, this Court held that the taxpayer had the burden of proof that application of a particular apportionment formula produces duplicative taxation and failed to meet that burden[4]. This Court declined to endorse the generally prevailing three-factor formula as a uniform rule for the division of income. Instead, this Court observed that "[i]t is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income." 437 U.S. at 280.

Many states have relied upon the holding in Moorman to justify shifting state tax burdens from local businesses to nondomiciliary businesses. As noted infra, single-factor sales formulas operate to tax income of out-of-state businesses disproportionately to business transacted within and without the state. The single-factor sales formula, used by Iowa and upheld in Moorman, is no longer a curious anomaly, but is

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[4]The taxpayer in Moorman also raised a due process argument claiming that Iowa's formula resulted in extraterritorial taxation. This Court ruled against the taxpayer on this issue holding that the taxpayer had failed to impeach formula apportionment through separate accounting. Notwithstanding the suggestion in footnote 9 of the opinion that such a showing might be possible, (437 U.S. at 275-6), no taxpayer has ever been successful before this Court attacking a state net income or franchise tax on these grounds since the 1931 decision in Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931).

instead a growing threat to multistate businesses that provide products or services from the home state to customers in many states.[5] Other states have aimed at the same result by increasing the weight of the sales factor in the standard apportionment formula of property, payroll, and sales.[6] In the past fourteen years since Moorman, Congress has failed to enact any uniform rules.

The growing burden upon interstate commerce from such multiple taxation warrants further action by this Court. This Court need not promulgate comprehensive uniform rules of multistate taxation as it rightly declined to do in Moorman. Instead, this Court should address the problem of multiple taxation by invalidating apportionment formulas that disregard the fact that capital and labor are major income producing activities.

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[5]At least 6 states now utilize a single-factor apportionment formula applicable to various types of financial and/or non-financial businesses. See, e.g., Ga. Code Ann. §48-7-31(d)(1)(B); Ind. Code §6-5.5-2-4; Neb. Rev. Stat. §77-2734.05; S.C. Code Ann. §12-7-1190; Tenn. Code Ann. §67-4-815; and W.Va. Code §11-24-7b(b)(4)(A).

[6]See, e.g., Ariz. Rev. Stat. Ann. §43-1139; Conn. Gen. Stat. §12-218; Fla. Stat. §220.15(4); Ill. Rev. Stat. Ch. 120, §3-304(a); Ky. Rev. Stat. Ann. §141.120(8); Me. Rev. Stat. Ann. tit. 36, §5211.8; Mass. Gen. L. Ch. 63, §38(c); Mich. Stat. Ann. §208.45; Minn. Stat. §290.191.3; N.H. Rev. Stat. Ann. §77-A:3,I and §77-A:3,II(a); Ohio Rev. Code Ann. §5733.05(B)(2); Or. Rev. Stat. §314.650 and Wis. Stat. §71.25(6).

2. Apportionment And Sourcing Rules That Look Primarily Or Solely To The Destination Of Sales And Disregard The Location Of Other Income-Producing Activities Are Unconstitutional Under The Commerce Clause.

In Moorman, this Court observed that the Commerce Clause "is neutral with respect to the content of any uniform rule" for the division of income. 437 U.S. at 279. This neutrality, however, must not override the constitutional prohibitions of unfair apportionment and discrimination against interstate commerce set forth in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). Thus, although the Commerce Clause does not define the ideal uniform rule for the division of income, it must be read to disapprove certain formulas that promote multiple and discriminatory tax burdens by disregarding fundamental income-producing activities outside the state.

A state must apportion unitary business income "on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." Container, 463 U.S. at 164-65. An apportionment formula that largely or entirely disregards the location of capital and labor, and focuses primarily or solely upon sales according to customer location, discriminates in favor of local businesses with out-of-state sales and against out-of-state businesses with in-state sales. Such a formula

apportions a greater percentage of income of out-of-state businesses and a smaller percentage of the income of local businesses than does a three-factor formula that gives equal weight to property and payroll.[7] It is precisely this discriminatory impact that the Commerce Clause prohibits.

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[7]The three-factor formula, by contrast, reflects a "very large share" of the income producing activities. Container, 463 U.S. at 183; Trinova Corp. v. Michigan Treasury Dept., 111 S.Ct. 818, 112 L.Ed. 2d at 911 (1991).

CONCLUSION

As the above argument points out, this Court should articulate principles to ensure that multistate businesses are not subjected to multiple and discriminatory state taxation.

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April 10, 1992

No. 91-615

Supreme Court, U.S.
FILED
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OFFICE OF THE CLERK

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BRIEF OF AMICI CURIAE AMWAY CORPORATION, ASEA BROWN BOVERI, INC., ASHLAND OIL, BORDEN, INC., AND THE LIMITED STORES IN SUPPORT OF PETITIONER ON REARGUMENT

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
STATEMENT OF INTEREST	1
INTRODUCTION AND SUMMARY OF ARGUMENT	2
ARGUMENT	5
I. THE UNITARY PRINCIPLE SHOULD BE PRESERVED SINCE IT ALLOWS STATES TO REACH THE FULL MEASURE OF THEIR TAXING AUTHORITY WHILE PROVIDING IMPORTANT PROTECTION TO MULTI-STATE BUSINESSES	5
II. OVERRULING *ASARCO* AND *WOOLWORTH* TO PERMIT NON-DOMICILIARY STATES TO REACH PASSIVE INVESTMENT INCOME WOULD BE BOTH UNWARRANTED AND DISRUPTIVE	9
III. THE COURT SHOULD MAINTAIN STABILITY IN THE AREA OF STATE TAXATION	14
A. Considerations of *Stare Decisis* Counsel Adherence to this Court's Decisions	15
B. The Failure of Congress To Legislate in this Area also Counsels this Court Not To Overrule *ASARCO* and *Woolworth*	20
IV. IF THIS COURT ABANDONS THE UNITARY BUSINESS PRINCIPLE, IT SHOULD REQUIRE THAT STATES ENGAGE IN FAIR APPORTIONMENT	22
CONCLUSION	28

TABLE OF AUTHORITIES

Cases

ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) ..... *passim*
Adams Express Co. v. Ohio State Auditor, 166 U.S. 185 (1897) 6
Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 6, 7
Amerada Hess Corp. v. Conrad, 410 N.W.2d 124 (N.D. 1987) 27
Amerada Hess Corp. v. Director, N.J. Div. of Taxation, 490 U.S. 66 (1989) 2, 22, 24, 25
American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266 (1987) 25
Arizona v. Rumsey, 467 U.S. 203 (1984) 14
Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) 3, 24
Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) 25
Bass, Ratcliff & Gretton Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) 6
Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) 26
Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977) 3, 25
Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932) 21
Butler Bros. v. McColgan, 315 U.S. 501 (1942) 6
Caterpillar Tractor Co. v. Department of Revenue, 618 P.2d 1261 (Ore. 1980) 8
CBS Inc. v. Comptroller of the Treasury, 575 A.2d 324 (Md. 1990) 27
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 18, 19, 20
City of Akron v. Akron Center for Reproductive Health, Inc., 462 U.S. 416 (1983) 14
Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) 21
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 2, 12, 13, 24
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 11, 12, 13, 23, 27

TABLE OF AUTHORITIES—Continued

	Page
Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977)	21
Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984)	15
Corn Products Refining Co. v. Commissioner of Internal Revenue, 350 U.S. 46 (1955)	12
Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980)	11, 15, 16
F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354 (1982)	*passim*
Fargo v. Hart, 193 U.S. 490 (1904)	25
Farmers Loan & Trust Co. v. Minnesota, 280 U.S. 204 (1930)	10
Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939)	6
Fort Howard Paper Co. v. Oklahoma Tax Comm'n, 792 P.2d 87 (Okla. App. 1989)	27
General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965)	26
General Motors Corp. v. Washington, 377 U.S. 436 (1964)	5
Goodman v. Lukens Steel Co., 482 U.S. 656 (1987)	15
Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931)	6, 23
Helvering v. Griffiths, 318 U.S. 371 (1943)	18
Helvering v. Hallock, 309 U.S. 106 (1940)	16
James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439 (1991)	17
Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979)	24
McCarroll v. Dixie Greyhound Lines, Inc., 309 U.S. 176 (1940)	21
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)	*passim*
Monell v. Department of Social Services, 436 U.S. 658 (1978)	14, 16, 17, 21
Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978)	*passim*
Moragne v. States Marine Lines, Inc., 398 U.S. 375 (1970)	16

TABLE OF AUTHORITIES—Continued

Page

National Bank v. Whitney, 103 U.S. 99 (1880) 17, 21
National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967) 10
Nippert v. Richmond, 327 U.S. 416 (1946) 25
Norfolk & Western R. Co. v. Missouri State Tax Comm'n, 390 U.S. 317 (1868) 10, 23, 27
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) 6, 21
Patterson v. McLean Credit Union, 491 U.S. 164 (1989) 14, 15
Payne v. Tennessee, 111 S. Ct. 2597 (1991) 14, 16
Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891) 6
Quill Corp. v. North Dakota, No. 91-194 (U.S. cert. granted Oct. 7, 1991) 4, 22
Southern Ry. Co. v. Kentucky, 274 U.S. 76 (1927) .. 25
Standard Oil Co. v. Peck, 342 U.S. 382 (1952) 24
State Railroad Tax Cases, 92 U.S. 575 (1876) 6
Swift & Co. v. Wickham, 382 U.S. 111 (1965) 18
Thomas v. Washington Gas Light Co., 448 U.S. 261 (1980) 16
Thornburgh v. American College of Obstetricians and Gynecologists, 476 U.S. 747 (1986) 14
Trinova Corp. v. Michigan Dep't of Treasury, 111 S.Ct. 818 (1991) ..... *passim*
True v. Heitkamp, 470 N.W.2d 582 (N.D. 1991) 27
Twentieth Century-Fox Film Corp. v. Department of Revenue, 700 P.2d 1035 (Or. 1985) 27
Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue, 483 U.S. 232 (1987) 24
Union Tank Line Co. v. Wright, 249 U.S. 275 (1919) 25
United States Glue Co. v. Oak Creek, 247 U.S. 321 (1918) 7
United States v. South Buffalo R. Co., 333 U.S. 771 (1948) 21
Vasquez v. Hillery, 474 U.S. 254 (1986) 16
Wallace v. Hines, 253 U.S. 66 (1920) 5, 6, 7, 25

TABLE OF AUTHORITIES—Continued

	Page
Walling v. Halliburton Oil Well Cementing Co., 331 U.S. 17 (1947)	17
Welch v. Texas Dep't of Highways and Public Transportation, 483 U.S. 468 (1987)	14
Western Union Telegraph Co. v. Taggart, 163 U.S. 1 (1896)	6
Westinghouse Electric Corp. v. Tully, 466 U.S. 388 (1984)	24
Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1936)	10
Williams v. Florida, 399 U.S. 78 (1980)	16
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)	8, 12
United States Constitution	
U.S. Const. art. I, § 8, cl. 3	2, 20
U.S. Const. amend. XIV, § 1	2, 15, 18, 20
Statutes	
28 U.S.C. § 1341 (1988)	25
Cal. Rev. & Tax Code § 25663 (West 1979 & Supp. 1992)	18
Md. Code Ann. Tax-General § 10-402(a) (1988 & Supp. 1991)	27
Mont. Code Ann. § 15-31-312 (1991)	27
N.J. Stat. Ann. § 54:10A-8 (West 1986)	27
Or. Rev. Stat. § 314.670 (1991)	27
Wis. Stat. § 1087m-1 (1911)	10
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J. Hellerstein & W. Hellerstein, *State and Local Taxation* (5th ed. 1988)	13
J. Hellerstein, *State Taxation* (1983)	9, 10
L. Silverstein, *Problems of Apportionment in Taxation of Multistate Business*, 4 Tax L. Rev. 207 (1949)	10

TABLE OF AUTHORITIES—Continued

Page

Note, *State Taxation of Interstate Business and the Multistate Tax Compact: The Search for a Delicate Uniformity*, 11 Colum. J. Law & Soc. Probs. 231 (1975) 3
P. Hartman, *Collection of the Use Tax on Out-of-State Mail Order Sales*, 39 Vand. L. Rev. 993 (1986) 21
The Federalist, No. 78 (A. Hamilton) (H. Lodge ed. 1888) 14
Uniform Division of Income for Tax Purposes Act § 1(a) & (e) 11, 12, 16, 26, 27
W. Knepper, *Liability of Corporate Officers and Directors* § 14.02 (3d ed. 1978) 17
W. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747 (1957) 13
1 State Tax Guide (CCH) ¶ 10-110 8
1920 Model Business Income Tax Act 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-615

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF AMICI CURIAE AMWAY CORPORATION, ASEA BROWN BOVERI, INC., ASHLAND OIL, BORDEN, INC., AND THE LIMITED STORES IN SUPPORT OF PETITIONER ON REARGUMENT

STATEMENT OF INTEREST[1]

Amici are multistate and multinational companies that are engaged extensively in interstate commerce. These companies, although representing different industries, have an interest in avoiding duplicative, burdensome, and discriminatory state taxation, and in the orderly development of the law in this area.

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[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of this Court.

Amici did not file a brief in this case when it was first argued, and have not now briefed the question of how this case should be resolved under this Court's settled case law. However, they oppose New Jersey's position in this case that the Court should dispense with the unitary business principle and overrule *ASARCO v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F. W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982).

INTRODUCTION AND SUMMARY OF ARGUMENT

In the area of state taxation, the protections of the Commerce Clause and the Due Process Clause are nearly identical.[2] As this Court summarized in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), the constitutional requirements are satisfied if "the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." This test, although formulated to meet Commerce Clause standards, "encompasses as well the Due Process requirement that there be 'a minimal connection between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. 818, 828 (1991) (quoting *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980) (internal quotations omitted)).

This case implicates two of those requirements: nexus and fair apportionment. But underlying both of those requirements is the central purpose of the Commerce Clause—to prevent discrimination against interstate com-

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[2] *See Trinova Corp. v. Michigan Dep't of Treasury*, 111 S.Ct. 818, 828 (1991); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 443 (1980); *Amerada Hess Corp. v. Director, N.J. Div. of Taxation*, 490 U.S. 66, 80 (1989) (Scalia, J., concurring).

merce. Where a state seeks to tax values beyond its borders, either by allocating income to the state as to which there is no nexus or by unfair apportionment, there is a risk that the state may be discriminating against interstate commerce in two ways.

To begin with, the taxing state may be seeking to eliminate a competitive advantage enjoyed by another state that has determined to attract interstate businesses through a lower tax rate or a narrower tax base. For example, a state seeking to encourage business within its borders may choose to exempt from taxation certain kinds of passive income of corporations having their commercial domicile in the state. This Court only last Term made clear the legitimacy of a state tax policy designed to attract such business,[3] and the threat to such competition posed by extraterritorial taxation is obvious. If other states can tax income that is not rightfully subject to their jurisdiction or tax a disproportionate share of income, any advantage conferred by the low-tax state would be, at the very least, substantially diluted.

Additionally, the taxing state may in fact be discriminating against interstate commerce by creating a taxing scheme that, while facially neutral, imposes disproportionate burdens on interstate business. A state tax formula that is "significantly out of line" with the practices in other states may in fact be designed to discriminate against out-of-state business, thereby harming interstate commerce.[4]

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[3] *See Trinova*, 111 S.Ct. at 835 ("States are free to 'structur[e] their tax systems to encourage the growth and development of intrastate commerce and industry' ") (quoting *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 324-328 (1977)); *Armco, Inc. v. Hardesty*, 467 U.S. 638, 645-646 (1984).

[4] *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 295 (1978) (Powell, J. dissenting). *See also* Note, *State Taxation of Interstate Business and the Multistate Tax Compact: The Search for a Delicate Uniformity*, 11 Colum. J. Law & Soc. Probs. 231, 236-237 and nn.15-16 (1975).

Inconsistent state interests and laws have long stymied attempts to impose federal uniformity in the area of interstate taxation.[5] In the meantime, states have become increasingly aggressive in interstate taxation.[6] However, the unitary business principle has for over a century stood as a protection against such extraterritorial and potentially discriminatory taxation. The State in this case seeks to eviscerate that protection. At the argument in this case, New Jersey for the first time requested that this Court overrule *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982), on two grounds.[7] Tr. at 31-32. First, the State urged that nondomiciliary states be permitted to apportion the unrelated passive investment income of unitary businesses. Second, New Jersey urged that the unitary business principle be abandoned entirely so that all income may be apportioned by any state in which the overall business conducts any operations. For example, if a corporation with one affiliate manufacturing computers on the East Coast has a wholly separate affiliate operating an amusement park on the West Coast, it may now structure its operations so that there is no relationship, apart from common ownership, between the East Coast affiliate and the West Coast operation. Nonetheless, under New Jersey's argument, the state with the computer business would apportion the income generated from the entire enterprise, despite the complete absence of a connection between that state and the amusement park business.

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[5] *See, e.g.*, E. Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171, 177 (1970).

[6] *See e.g., Quill Corp. v. North Dakota*, No. 91-194 (U.S. cert. granted Oct. 7, 1991).

[7] Although New Jersey did not urge these positions in its initial brief in this Court, the argument was raised by California and eight other states in their brief *amici curiae*. *See* Cal. Am. Br. 20. References herein to "Tr." are to the Transcript of Oral Argument (March 4, 1992).

While states may, consistent with Due Process, look beyond their borders to "get the true values of the things within it," it has long been this Court's position that the Constitution does not permit this authority to "expose the heel of the system to a mortal dart—not, in other words, to open to taxation what is not within the State." *Wallace v. Hines*, 253 U.S. 66, 69 (1920) (Holmes, J.). And as the Court reiterated just two Terms ago in *Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. at 836, the Constitution is "a defense against state taxes which . . . either give rise to serious concerns of double taxation, or attempt to capture tax revenues that, under the theory of the tax, belong of right to other jurisdictions."

A primary protection in this area has been the unitary business principle, which has long stood as "the linchpin of apportionability. . . ." *Mobil Oil Corp.*, 445 U.S. at 439. The rules with respect to the attribution of income of passive investments have produced a similar, but more limited protection. No one is suggesting that this Court should attempt to issue a uniform state code of taxation, but neither should the Court eviscerate the protection against unfair, burdensome, and discriminatory taxation provided by the unitary business principle and the passive investment rule.

ARGUMENT

I. THE UNITARY PRINCIPLE SHOULD BE PRESERVED, SINCE IT ALLOWS STATES TO REACH THE FULL MEASURE OF THEIR TAXING AUTHORITY WHILE PROVIDING IMPORTANT PROTECTION TO MULTISTATE BUSINESSES.

For a century, the unitary business principle has governed state taxation, serving as both a grant of authority to states to look beyond their borders (in order to value properly the instate activities of a multistate business) and as a bar to taxing values that are unrelated to the instate activities of a business. *See, e.g., General Motors Corp.*

v. Washington, 377 U.S. 436, 439 (1964); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959); *Butler Bros. v. McColgan*, 315 U.S. 501, 508 (1942); *Ford Motor Co. v. Beauchamp*, 308 U.S. 331, 336 (1939); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 132-133 (1931); *Bass, Ratcliff & Gretton Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924); *Wallace v. Hines*, 253 U.S. at 69; *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 221-222 (1897); *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185, 219-224 (1897). However, under New Jersey's broader theory—that the unitary business principle should be eliminated entirely—every operation commonly owned would be treated, for state taxation purposes, as a single unitary business regardless of its relationship to the in-state activities.

The "unitary" concept arose in the late 19th century as a method for valuing transportation and communication systems that traversed state boundaries. The Court recognized that a state could assess a tax by valuing the entire property as a unit and, through application of a formula, determine the taxing state's share of that value. *See, e.g., Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 26 (1891); *Western Union Telegraph Co. v. Taggart*, 163 U.S. 1, 18 (1896). This "unit rule" accounted for the fact that through common ownership and use, the true value of the property may exceed the cost of the property itself. *See State Railroad Tax Cases*, 92 U.S. 575, 608 (1876). Thus, the value of the miles of railway track within a state is heightened when that track crosses into a second state. A failure to account for that aspect would result in undervaluing the instate miles of track. As this Court has recognized,

> The only reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess.

Wallace v. Hines, 253 U.S. at 69. At the same time this Court made clear that "[t]he purpose is not . . . to open to taxation what is not within the State. Therefore no property . . . situated [out-of-state] can be taken into account unless it can be seen in some plain and fairly intelligible way that it adds to the value of the [enterprise] and the rights exercised in the State." *Id.*

Although first applied to cases in which physical unity was manifest, the rule was soon applied where only operational, rather than physical, unity was present. *See Adams Express Co.*, 165 U.S. at 220. Although physically unconnected, the value of an express company's property in one state would not be fairly reflected without considering its operational connection to property in other states. The principle was then extended to the income tax calculations for companies operating across state lines. *See United States Glue Co. v. Oak Creek*, 247 U.S. 321, 328-329 (1918).

Translated to the modern enterprise, the unitary business is one in which corporate constituents are involved in an economically functionally-related enterprise. If a corporation's income-producing activity in one state is inextricably linked with its activities in another state, or if the businesses of separate affiliates are intertwined, there is a unitary business. The taxable income is thus apportioned to a state based on the total income produced, without regard to state lines or corporate structure. The requisite unity is, however, more than ownership. "It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business." *Adams Express Co.*, 165 U.S. at 222.

Although the unitary business principle is central to this Court's state taxation jurisprudence, New Jersey asks that it be abandoned. The unitary principle, however, ably serves its intended purpose. A state's taxing power must "bear fiscal relation to protection, opportuni-

ties and benefits given by the state." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). Simply put, the state must have given something "for which it can ask return." *Id.* New Jersey has given no insight into the benefits it provides to an out-of-state business having no connection with the State. Given the radical nature of New Jersey's request—wholesale abandonment of a central tenet of constitutional doctrine—it would be expected that New Jersey would show that the unitary system somehow prohibits it from reaching what rightfully belongs to New Jersey. New Jersey has not even suggested, much less made a showing, that the existing unitary structure has deprived it of the ability to capture income that is properly its to tax. Nor has it shown that the unitary principle is unworkable. In short, New Jersey has established no basis for overruling the unitary cases stretching back over a century, and allowing states to sweep within their taxing jurisdiction activities wholly unrelated to instate business.

This improper expansion of state power to tax is of particular concern in those states that require combined reporting.[8] Under combined reporting, the income of

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[8] A combined report is an "*accounting* method whereby each member of a group carrying on a unitary business computes its individual taxable income by taking a portion of the combined net income of the group." *Caterpillar Tractor Co. v. Department of Revenue*, 618 P.2d 1261, 1263-64 (Ore. 1980) (emphasis in original).

A number of states currently require combined reporting for unitary businesses (*see, e.g.* Arizona, California), while others provide for it under certain circumstances (*see, e.g.*, Michigan, New York). *See* 1 State Tax Guide (CCH) ¶ 10-110 at 1071-1072. Combined reporting may be required by statute, by regulation, or by directive of the taxing authority.

Unlike a combined return, a consolidated return is appropriate for corporate affiliates, all of which are taxable in the state. The separate entities of the various member corporations are disregarded, the consolidated income of the entire group is reported on a single return, and a single tax is paid on that income. Rudolph, 25 Tax L. Rev. at 197.

affiliates that are not taxable in the state are nonetheless included in the determination of an instate corporation's income. Combined reporting requires that the income of a business conducted partly within and partly without the taxing state be determined and apportioned in the same manner regardless of whether the business is conducted by one corporation or by two or more affiliated corporations.[9] If the unitary business principle were abandoned, the state could, through revision or reinterpretation of existing law, require entities engaged in separate businesses that are unrelated except for common corporate ownership to file a single combined return. The state would thus be taxing a business on the income of an affiliated entity engaged in wholly unrelated activities. And, as described below, because of the broad flexibility states currently have with respect to apportionment formulas, *see Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978), constitutional restraints on state apportionment provide little, if any, protection against states reaching extra-territorial values. This Court should not thus expand state tax jurisdiction, particularly based on the incomplete record in this case.[10]

II. OVERRULING *ASARCO* AND *WOOLWORTH* TO PERMIT NON-DOMICILIARY STATES TO REACH PASSIVE INVESTMENT INCOME WOULD BE BOTH UNWARRANTED AND DISRUPTIVE.

New Jersey, in a proposal somewhat less radical than abandoning the unitary principle, has alternatively requested that the Court modify the unitary business principle to permit it to reach the income of passive invest-

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[9] *See* Rudolph, 25 Tax L. Rev. at 197; J. Hellerstein, *State Taxation* ¶ 8.12, at 462-63 n.527 (1983).

[10] Because New Jersey had not raised this claim in any of the prior proceedings, there is an absence of a factual record on this issue, which counsels against this Court addressing it at this juncture.

ments. In so urging, it again asks that this Court overrule past decisions that have provided important limitations on state power to tax.

Historically, States have allocated rather than apportioned the income received by a unitary business from its passive investments.[11] *See Moorman Mfg. Co. v. Bair*, 437 U.S. at 272-73; *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967); *Norfolk & Western R. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317, 325 (1868). Like real property, the location of intangible property was considered determinable; therefore, so long as it did not form an "integral part[] of some local business," *Farmers Loan & Trust Co. v. Minnesota*, 280 U.S. 204, 213 (1930), such property was located at the business situs or commercial domicile, and was properly attributable in full to that state. *See Wheeling Steel Corp v. Fox*, 298 U.S. 193 (1936).

Recognizing the appropriateness of this practice, Wisconsin, in creating the modern corporate income tax, provided for apportionment of most income, but retained the allocatation of income derived from passive investments. *See* Wis. Stat. § 1087 m-1 (1911). The 1920 Model Business Income Tax Act adhered to this approach, and by 1940, most states with corporate income taxes did so as well.[12] Adhering to the long-standing practice, the majority of states today allocate passive investment income to the state of domicile,[13] and it is the specified treat-

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[11] "Allocation" refers to attributing an item of property, income, receipts, and the like to a particular state, based on tracing the source of income to that State. Hellerstein, *State Taxation* ¶ 8.4, at 328 n.95. Where a state "allocates" income, it taxes 100% of that income. In contrast, apportionment is the assignment of that portion of an enterprise's total income that is attributable to the taxing state. *See id.*

[12] *See* L. Silverstein, *Problems of Apportionment in Taxation of Multistate Business*, 4 Tax L. Rev. 207, 210 (1949).

[13] *See* Appendix to Brief of Allied-Signal on Reargument.

ment in the Uniform Division of Income for Tax Purposes Act ("UDITPA"). *See* UDITPA § 1(a) & (e).

This approach comports with longstanding constitutional doctrine developed from the unitary business cases. The Court consistently has found that the Due Process and Commerce Clauses prohibit state taxation absent a minimal connection between the interstate or international activities and the taxing state, and a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *See, e.g., Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 219-20 (1980). The unitary nature of the business supplied the nexus and rational relationship essential to apportionment. As the Court has recognized, "the linchpin of apportionability in the field of state income taxation is the unitary business principle." *Mobil Oil Corp.*, 445 U.S. at 439.

In *ASARCO Inc. v. Idaho State Tax Comm'n*, and *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, this Court made clear that the constitutional limitations preclude states from including in the taxable income of a nondomiciliary parent corporation the passive investment income of subsidiaries that have no other connection with the taxing state. The Court has subsequently reiterated that an exchange of value beyond "the mere flow of funds arising out of a passive investment" is necessary before a state may permissibly tax the out-of-state income from passive, uncontrolled investments of an otherwise unitary business. *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 166 (1983).

New Jersey's request that this longstanding approach be reversed raises several problems. To begin with, the gain or loss from passive investments is a product of managerial activities and decision-making occurring in the commercial domiciliary state, not in the state in which, for example, the nondomiciliary corporation operates a manufacturing concern. The intangibles giving rise to dividends are generally acquired, managed, and held at

the taxpayer's headquarters in the state of commercial domicile. While New Jersey may have a relationship to Bendix's organic business activities, New Jersey has not demonstrated that it provides any sort of benefit to or has any nexus with activities generating passive investment income. *See Complete Auto*, 430 U.S. at 279; *Wisconsin v. J.C. Penny Co.*, 311 U.S. at 443.[14]

Additionally, as a practical matter, permitting nondomiciliary states to tax passive investment income will not alleviate any of the complexities that may be encountered in determining taxable income and will, in fact, increase the risk of multiple taxation. States that currently allocate passive investment income of domiciliaries are likely to continue to do so.[15] At the same time, other states could well seek to apportion the identical income.

Finally, New Jersey has not indicated how states would determine their aliquot share of passive investment income. It would, of course, be necessary to determine the proper portion attributable to the unitary business (and the state's share of that amount) and how much instead should be attributed to other entities. But the traditional three-factor apportionment formulation, which is based on the proportion of a unitary business' total payroll, property, and gross receipts located in the taxing state, does not bear any sort of rational relationship to the out-of-state values of intangible income. That formula, widely used today for apportioning the tangible business income

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[14] The principle of *ASARCO* and *Woolworth* is not designed to protect from apportionment income that is functionally related to an enterprise, but instead income from passive investments. *See Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 180 n.19 (1983). *Cf. Corn Products Refining Co. v. Commissioner of Internal Revenue*, 350 U.S. 46 (1955).

[15] At the very least, the outcome requested by New Jersey would require the revision of statutes in each state that has adopted UDITPA's distinction between business and nonbusiness (passive) income.

of unitary enterprises, was designed to measure the income arising from tangibles and to "reflect a very large share of the activities by which value is generated." *Container Corp.*, 463 U.S. at 183.

The theory underlying the three-factor formula, and indeed, the basis for its acceptability for Commerce Clause purposes, is that a dollar of payroll or property or a dollar of sales made in one state, produces roughly the same amount of taxable income as a dollar in another state.[16] But this theory makes clear that the factors have virtually no relevance to dividends or to capital gains derived from the sale of stock in an unrelated business.[17] Little of the taxpayer's payroll is required, for example, to collect dividends, nor is there any reason to believe that investment income is related to the states in which goods are sold in the taxpayer's regular course of business operations. Similarly, the amount of tangible property located in the state of manufacturing has no relevance to investment decisions made at corporate headquarters located in a different state.

Overruling *ASARCO* and *Woolworth* would require the Court to reexamine an unbroken line of cases holding that, to meet the constitutional standards, a tax must be "applied to an activity with a substantial nexus with the taxing state." *Complete Auto*, 430 U.S. at 279. It could also create new problems in state taxation, as states with no connection to an out-of-state activity may nonetheless try to reach that activity's income, leading inevitably to multiple taxation and apportionment complications. New Jersey has provided no basis for disrupting the current scheme. Under these circumstances, *ASARCO* and *Woolworth* should be retained.

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[16] *See* J. Hellerstein & W. Hellerstein, *State and Local Taxation* 577 (5th ed. 1988).

[17] The drafter of UDITPA has acknowledged that the allocation and apportionment sections of the uniform act are "a formula designed for manufacturing and merchandising businesses." W. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 749 (1957).

III. THE COURT SHOULD MAINTAIN STABILITY IN THE AREA OF STATE TAXATION.

The Court has asked whether *ASARCO* and *Woolworth* should be overruled,[18] but the plain fact is that far more is at stake. As noted above, *supra* pp. 5-6, New Jersey's proposal to have this Court abandon the unitary business principle would undermine decades of settled constitutional precedent. Even New Jersey's narrower effort to allow states to apportion passive investment income would force this Court to reassess its settled principles. Under the doctrine of *stare decisis*, a party seeking to have this Court overrule precedent must provide "special justification" [19] for that extraordinary step, and that is sorely lacking in this case.

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[18] *See* Order in No. 91-615 (March 11, 1992) ("Order").

[19] *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984). "[*S*]*tare decisis* is a basic self-governing principle within the Judicial Branch, which is entrusted with the sensitive and difficult task of fashioning and preserving a jurisprudential system that is not based upon 'an arbitrary discretion.'" *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989) (quoting The Federalist, No. 78, at 490 (A. Hamilton) (H. Lodge ed. 1888)). *See also Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991); *Welch v. Texas Dep't of Highways and Public Transportation*, 483 U.S. 468, 494 (1987) ("the doctrine of *stare decisis* is of fundamental importance to the rule of law"). While *stare decisis* has almost invincible force in statutory cases (*Monell v. Department of Social Services*, 436 U.S. 658, 695 (1978)), in constitutional cases as well, "[t]here is a strong public interest in stability, and in the orderly conduct of our affairs, that is served by a consistent course of constitutional adjudication." *Thornburgh v. American College of Obstetricians and Gynecologists*, 476 U.S. 747, 780-81 (1986) (Stevens, J., concurring). Thus, in constitutional cases, special justification is required before this Court will overrule precedent. *See Rumsey*, 467 U.S. at 212; *City of Akron v. Akron Center for Reproductive Health, Inc.*, 462 U.S. 416, 419-20 (1983).

A. Considerations of *Stare Decisis* Counsel Adherence to this Court's Decisions.

In determining whether to break with past decisions, this Court has utilized a variety of considerations, each of which suggest that *ASARCO* and *Woolworth* should be reaffirmed. *ASARCO* and *Woolworth* were decided not through incomplete analysis, but after extensive briefing both by the parties themselves and *amici* representing different perspectives on the issues. *Cf., e.g., Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 766 (1984). Neither the law nor the factual context has changed in the decade since those decisions were rendered: this Court invoked *ASARCO* and *Woolworth* a year later in *Container* and has not given any indication that the unitary business principle, as applied in those decisions, no longer limits state taxation consistent with Due Process. *Cf., e.g., Goodman v. Lukens Steel Co.*, 482 U.S. 656, 659-62 (1987); *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989). Thus, this Court should not lightly upset this area of the law. A number of additional considerations suggest that *stare decisis* interests have particular weight in this case.

First, the sheer magnitude of New Jersey's proposed change counsels particular caution. New Jersey's suggestion that this Court abandon the unitary business principle would put in question literally dozens of this Court's precedents, all of which were grounded on the fact that a state may include out-of-state values in its computation of tax only when they are related to a unitary business that is carried on in the taxing state. *See, e.g., Exxon*, 447 U.S. at 219-220.

Even if the Court were to accept New Jersey's narrower proposition and hold that passive investment income is apportionable, the change would be profound. In addition to overruling *ASARCO* and *Woolworth*, the Court would also have to resolve the inconsistency of its new holding with decisions—especially *Mobil* and *Exxon*

—that preceded and forecast the *ASARCO* and *Woolworth* holdings. *See ASARCO*, 458 U.S. at 315 (noting reliance on *Mobil*); *Woolworth*, 458 U.S. at 362 (noting reliance on *Mobil* and *Exxon*).[20]

Second, it is hardly surprising that businesses have planned their tax and economic affairs according to the unitary business principle, filing their tax returns in various jurisdictions in reliance on this Court's settled law. Reliance interests always require this Court to reassess precedents with caution,[21] but stability and predictability are especially important for business decisionmaking. "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved . . . ." *Payne v. Tennessee*, 111 S. Ct. 2597, 2610 (1991).[22] Businesses

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[20] In addition, most states would have to rework their taxation schemes which, modeled after UDITPA, rest on the distinction between business and nonbusiness income. *See supra* p. 10.

[21] *See, e.g., Monell v. Department of Social Services*, 436 U.S. at 700.

[22] The core of *stare decisis* is that the principle furthers "the stability and predictability required for the ordering of human affairs over the course of time." *Williams v. Florida*, 399 U.S. 78, 127 (1970) (Harlan, J., concurring in part and dissenting in part). *Stare decisis* ensures that "the law will not merely change erratically," and "permits society to presume that bedrock principles are founded in the law rather than in the proclivities of individuals." *Vasquez v. Hillery*, 474 U.S. 254, 265 (1986). It "embodies an important social policy. It represents an element of continuity in law, and is rooted in the psychologic need to satisfy reasonable expectations." *Helvering v. Hallock*, 309 U.S. 106, 119 (1940). Among the "weighty considerations" that "underlie the principle that courts should not lightly overrule past decisions," most important is enabling individuals "to plan their affairs with assurance against untoward surprise . . . ." *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375, 403 (1970). "When rights have been created or modified in reliance on established rules of law, the arguments against their change have special force." *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980).

carefully tailor their operations to this Court's decisions.[23] Where businesses have justifiably relied on precedent, overruling severely disrupts business planning and operation. Businesses have relied on *ASARCO* and *Woolworth* for a decade, and those reliance interests would be frustrated by this Court's overruling. *Cf., e.g., Monell v. Department of Social Services*, 436 U.S. 658, 700 (1978). Thus, as this Court has noted:

> Judicial decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons, certainly not because of subsequent doubts as to their soundness. The prosperity of a commercial community depends, in a great degree, upon the stability of the rules by which its transactions are governed.[24]

Maintaining stability in this area is particularly appropriate because any change would affect the tax consequences of past conduct.[25] Businesses have filed their tax returns in reliance on the unitary business principle generally, and on the Court's holdings in *ASARCO* and *Woolworth* that passive investment income that is unrelated to a company's unitary business in a taxing jurisdiction may not be apportioned by that state. Any change in this area

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[23] *See, e.g.*, W. Knepper, *Liability of Corporate Officers and Directors* § 14.02 at 418 (3d ed. 1978); J. Ayre, *Corporate Legal Departments: Strategies for the 1980s* 93 (1984).

[24] *National Bank v. Whitney*, 103 U.S. 99, 102 (1880). *See also, e.g., Walling v. Halliburton Oil Well Cementing Co.*, 331 U.S. 17, 25-26 (1947) (because of continued recognition of the precedent by the Court, Congressional acquiescence in the decision, and reliance by business, the Court notes that "[e]ven if we doubted the wisdom of [the precedent] as an original proposition, we should not be inclined to depart from it at this time").

[25] "Because it forces us to consider the disruption that our new decisional rules cause, retroactivity combines with *stare decisis* to prevent us from altering the law each time the opportunity presents itself." *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439, 2450 (1991) (Blackmun, Marshall, and Scalia, JJ., concurring in the judgment).

could impose substantial retroactive tax liabilities.[26] The Court has been especially hesitant to impose such tax liabilities, recognizing that retroactive surprises in the area of taxation are particularly unfair. *See, e.g., Helvering v. Griffiths*, 318 U.S. 371, 402-03 (1943). Thus, under the circumstances, *stare decisis* counsels the Court to reject New Jersey's proposals to unsettle the constitutional principles governing taxation of multistate enterprises.

Third, the unitary business principle as articulated and applied in *ASARCO* and *Woolworth* provides a far more workable standard for judging states' ability to impose tax obligations than any other alternative measure of Due Process nexus. *Cf., e.g., Swift & Co. v. Wickham*, 382 U.S. 111, 124-25 (1965). In fact, New Jersey has found the passive investment rule to be "workable," providing a "bright line" for businesses and taxing authorities. Tr. at 40. Thus, contrary to Justice O'Connor's concerns, there is no indication that *ASARCO* and *Woolworth* have created "staggering practical difficulties for taxpayers, state tax administrators, and ultimately, the courts." *ASARCO*, 458 U.S. at 348 (O'Connor, J., dissenting). In all events, adopting an alternative standard would create additional complexities and force this Court to scrutinize apportionment rules more closely. *See infra* pp. 24-30.

The same concerns that drive *stare decisis* also strongly counsel that, if the Court either abandons the unitary business principle or allows states to apportion unrelated passive investment income, such a decision be only prospective in application. Under *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), the Court may limit the retroactive effect of a decision if the case meets three criteria: (1) the decision "establish[es] a new principle of law, either by overruling clear past precedent on which litigants may have

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[26] States have varying, but nonetheless in some instances lengthy, limitations periods for assessment of additional taxes. *See, e.g.*, Cal. Rev. & Tax Code § 25663 (West 1979 & Supp. 1992) (four years). *See supra* n.25.

relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed"; (2) the Court has "weigh[ed] the merits and demerits . . . by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation"; and (3) the Court has "weighed the inequity imposed by retroactive application" and found that the new ruling "could produce substantial inequitable results if applied retroactively . . . ." *Id.* at 106-07 (citations omitted).

Amici have already demonstrated that this case satisfies the first prong of *Chevron Oil*. As shown above, the unitary business principle has been applied for a century, and the Court has never forecast *any* retreat from that principle. *See supra* pp. 5-6. *ASARCO* and *Woolworth* were merely correct applications of the Court's longstanding unitary business precedents, consistent with the statutes of most states (*supra* p. 10), and those decisions have not been questioned in the decade since they were announced. Thus, the abandonment or significant restriction of the unitary business principle would pose a clear and unpredictable break with the past.

This case also satisfies the second prong of *Chevron Oil*, because the policies behind any change in this Court's settled law would not be furthered by applying the decision retroactively. New Jersey appeared to advance two arguments in favor of change: states are entitled to more revenues than they currently receive from multi-state businesses, Tr. at 40; and the unitary business principle is unworkable, Tr. at 32-33, 38. Concerning the first argument, the State has conceded that its theory is at least "in considerable tension with" controlling law; thus, states are hardly entitled to retroactive revenues as a matter of fairness, since they are currently not entitled to those revenues at all. Regarding the second, as discussed earlier, *amici* simply disagree that the unitary business principle is unworkable (*supra*, p. 18), but even if this interest were legitimate, it would not justify imposing

retroactive liabilities on businesses that gauged their tax liabilities by *ASARCO*, *Woolworth*, and the unitary business principle during the past decade.

Finally, this case also satisfies the third prong of *Chevron Oil*, because retroactive application of any overruling decision would penalize businesses for having filed their tax returns for the past ten years in reliance on *ASARCO* and *Woolworth*. *Supra* p. 17. Thus, businesses might be forced not only to pay back taxes on vastly expanded tax bases but also interest and penalties for not having predicted this Court's overruling of settled precedent.

B. The Failure of Congress To Legislate in this Area also Counsels this Court Not To Overrule *ASARCO* and *Woolworth*.

This Court has repeatedly noted that it is institutionally unable to fashion a system of equitable rules of state taxation.[27] However, Congress has chosen not to act in this area. As a result, the Court's state taxation decisions have taken on added significance, providing businesses with the sole indications of how far states may permissibly reach in taxing multistate and multinational enterprises. Those decisions do not, however, preclude Congress from enacting a comprehensive system of state taxation.

Constitutional cases involving interstate taxation are not insulated from Congressional overruling simply because they may be grounded in Due Process concerns. In acting under its Commerce Clause authority, Congress could at the same time eliminate the Due Process problems. First, this Court noted in *ASARCO* itself that states are bound by Due Process jurisdictional requirements that do not apply to the federal government, which may

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[27] *See, e.g., Moorman Manufacturing Co. v. Bair*, 437 U.S. at 278-280.

act without regard to state boundaries. *See ASARCO*, 458 U.S. at 327-328 n.23. If states were utilized as agents for Congressional action, they would be insulated from the Due Process challenge that they are overreaching their geographical jurisdiction in taxing values of multistate entities.[28] Second, Congress would be able to fashion uniform apportionment rules which could alleviate the burdens of multiple taxation that result from state legislation in this area. *See, e.g., Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 628 (1981); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. at 476; *McCarroll v. Dixie Greyhound Lines, Inc.*, 309 U.S. 176, 188-189 (1940) (Black, Frankfurter, and Douglas, J.J., dissenting).

The unitary business principle, and cases like *ASARCO* and *Woolworth* that have applied it, are therefore entitled to strong deference because "correction can be had by [federal] legislation."[29] Here, as in statutory cases, Congress can make any necessary change "with infinitely less derangement of those interests than would follow a new ruling of the court, for statutory regulations would operate only in the future." *Whitney*, 103 U.S. at 102.

Congress remains the proper forum for addressing states' concerns about their ability to raise revenue and businesses' justified fears about multiple taxation. There, the question of how much burden on interstate commerce should be tolerated in light of state fiscal concerns can be addressed based on a complete factual record, important competing policies can be weighed, and multiple burdens could be avoided. If Congress were persuaded to

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[28] *See* P. Hartman, *Collection of the Use Tax on Out-of-State Mail Order Sales*, 39 Vand. L. Rev. 993, 1017-1028 (1986).

[29] *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting) (citation omitted). *See also, e.g., Monell v. Department of Social Services*, 436 U.S. at 695; *United States v. South Buffalo R. Co.*, 333 U.S. 771, 774 (1948); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 60 (1977) (White, J., concurring).

act, it could do so prospectively, to avoid upsetting reliance interests, and could implement changes using a phase-in period that would not suddenly impose new tax burdens on businesses. Unless that occurs, this Court's settled law in the area of state taxation should not be disturbed.[30]

IV. IF THIS COURT ABANDONS THE UNITARY BUSINESS PRINCIPLE, IT SHOULD REQUIRE THAT STATES ENGAGE IN FAIR APPORTIONMENT.

The Court has requested briefing on "what constitutional principles should govern state taxation of corporations doing business in several states" if *ASARCO* and *Woolworth* were overruled. *See* Order. This section addresses principles that should guide the Court if it either were to allow apportionment by states of a company's unrelated passive investment income, or were to go further and actually abandon the unitary business principle. In either case, this Court's current standards should be reevaluated.

This Court has long refused to closely scrutinize state apportionment rules, despite candid acknowledgment that those rules are merely rough estimates of the true taxable value of an interstate company's activity in a taxing state. *See, e.g., Amerada Hess Corp. v. Director, N.J. Div. of Taxation*, 490 U.S. 66, 74-75 (1989). Instead, apportionment rules have been upheld if they are merely "internally" and "externally" consistent. *Trinova*, 111 S. Ct. at 832. But neither test, as presently implemented, provides adequate protection of interstate commerce if state tax jurisdiction is expanded as New Jersey urges here.

The "internal consistency" test does not adequately identify impermissible multiple taxation burdens imposed

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[30] We note that many of the same issues concerning the preservation of existing authority are presented in *Quill Corp. v. North Dakota*, No. 91-194.

on interstate businesses. That test merely requires that a formula "be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." *Trinova*, 111 S. Ct. at 832 (quoting *Container*, 463 U.S. at 169). Under this abstract test, even a state allocation rule applied to income that every other state is apportioning might pass constitutional muster.

The "external consistency" test is similarly inadequate to protect interstate commerce from undue and discriminatory burdens. The Court has repeatedly stated that, in order to successfully challenge a state statute on "external consistency" grounds, the *taxpayer* "must prove by clear and cogent evidence that the income attributed to the State is in fact out of all apropriate proportions to the business transacted . . . in that State, or has led to a grossly distorted result." *Trinova*, 111 S. Ct. at 832 (internal citations and quotation marks omitted). *Accord, Container*, 463 U.S. at 170; *Moorman*, 437 U.S. at 274; *Norfolk & Western R. Co.*, 390 U.S. at 326; *Hans Rees' Sons*, 283 U.S. at 135. But while the Court has repeatedly concluded that taxpayers have not met their burden of proving unfairness, the Court has not provided any guidance to businesses on how a showing of external *in*consistency could be made. *See, e.g., Trinova*, 111 S. Ct. at 834; *Moorman*, 437 U.S. at 275. And given this Court's repeated criticisms of separate or geographic accounting,[31] it is difficult to understand how a company could prove that a state formula is, in fact, "captur[ing] tax revenues that, under the theory of the tax, belong of right to other jurisdictions." *Trinova*, 111 S. Ct. at 836.

If the Court were to overrule *ASARCO* and *Woolworth* and hold that a company's passive investment income could be apportioned to one or more of its unitary busi-

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[31] *See, e.g., Trinova*, 111 S. Ct. at 829-30; *Container*, 463 U.S. at 181; *Mobil*, 445 U.S. at 438.

nesses, the Court should recognize that allocation of passive investment income by a domiciliary state could no longer survive constitutional scrutiny. *Supra* n.20. This holding follows necessarily from the Court's longstanding recognition that if one jurisdiction allocates what other jurisdictions apportion, multiple taxation would inevitably arise. "The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 447 (1979). *See Standard Oil Co. v. Peck*, 342 U.S. 382, 384-85 (1952). Furthermore, the Court should require that states develop reasonable rules to attribute a given company's passive investment income to its various unitary businesses. Otherwise, multiple taxation of this income would inevitably occur. *See supra* p. 12.

If the Court were to actually abandon the unitary business principle, the Court would be forced to reassess even more fundamentally the principles it uses in evaluating state apportionment statutes. Since the "internal consistency" test does not adequately protect businesses against undue and discriminatory burdens, the Court's reevaluation should focus on "external" consistency.

The Court should be more sensitive to apportionment rules that may be unfair because they impose discriminatory burdens on out-of-state businesses.[32] Because of fed-

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[32] Alternatively, the Court could rely on the non-discrimination prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). "Even if a tax is fairly apportioned, it may discriminate against interstate commerce." *Amerada Hess*, 490 U.S. at 75. While a tax statute may be invalidated if it is facially discriminatory, *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 398-99 (1984), *Amerada Hess*, 490 U.S. at 75, or if it fails the internal consistency test, *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 483 U.S. 232, 247-48 (1987), *Armco Inc. v. Hardesty*, 467 U.S. at 644-45, those notions do not exhaust this Court's inquiry.

Under the Court's settled law, a state tax statute is also unconstitutional if it unjustifiably "favor[s] local commercial interests

eral law,[33] most interstate tax cases are litigated in state courts, which may not be as sensitive to discrimination against out-of-state companies. Thus, this Court should be alert to the very real possibility that out-of-state businesses may be unfairly treated relative to their instate competitors.[34] The Court should be willing to evaluate whether a state's taxing formula takes into account factors that are not reasonably aimed at determining the true value of a multistate enterprise attributable to a given state,[35] particularly when a company provides evidence that the formula benefits intrastate commerce at the expense of outsiders, or creates coercive incentives for businesses to relocate to a state.[36]

The Court should also take a closer look at state departures from the statutory approaches of other states, to determine whether these "outliers" impose special bur-

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over out-of-state businesses," *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. at 335, or if there is evidence of a state's "intent to confer a benefit upon local industry not granted to out-of-state industry," *Amerada Hess*, 490 U.S. at 76; *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270-71 (1984). Furthermore, this Court has invalidated state statutes that have "a discriminatory effect by exerting an inexorable hydrolic pressure on interstate businesses to ply their trade within the State that enacted the measure rather than among the several States. . . ." *Amerada Hess*, 490 U.S. at 76 (internal quotations and citations omitted); *see, e.g., American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266 (1987); *Nippert v. Richmond*, 327 U.S. 416 (1946). Nor will the Court countenance tax statutes that are facially neutral, but nevertheless "in their practical operation [work] discriminatorily against interstate commerce to impose upon it a burden, either in fact or by the very threat of [their] incidence." *Id.* at 425.

[33] 28 U.S.C. § 1341 (1988).

[34] *Cf. Moorman*, 437 U.S. at 289 (Powell, J., dissenting).

[35] *Wallace v. Hines*, 253 U.S. 66 (1920); *Union Tank Line Co. v. Wright*, 249 U.S. 275 (1919); *Fargo v. Hart*, 193 U.S. 490 (1904); *Southern Ry. Co. v. Kentucky*, 274 U.S. 76 (1927).

[36] *See Moorman*, 437 U.S. at 289 (Powell, J., dissenting).

dens on interstate commerce. Although, for example, this Court in *Moorman*, 437 U.S. 267, upheld Iowa's single-factor apportionment formula against a challenge that the State's unusual rule created undue and discriminatory burdens on interstate commerce, the approach taken by that decision would have to be reevaluated in the context of expanded state tax jurisdiction. If this Court were to abandon the unitary business principle, inconsistent apportionment formulas, which "ordinarily result in multiple taxation of corporate net income," [37] would impose even greater burdens on interstate commerce because states would be applying those inconsistent formulas to expanded tax bases. Where a taxpayer demonstrated that an apportionment formula's inconsistency with the formulas of other states raised a risk of burden on interstate commerce, the state should have to provide evidence justifying its unusual statute.[38]

The Court's analysis of fairness should also include whether the state has been consistent with respect to a particular taxpayer over time. States have incentives to manipulate their statutes to garner the greatest possible net revenues, by expanding taxpayers' apportionable income and denying deductions to taxpayers. States should be required to be consistent in their application of formulae to taxpayers and in their definition of a company's taxable activity in the state. Currently, most state statutes allow taxing authorities great discretion to vary the treatment of taxpayers on an *ad hoc basis*.[39] This untram-

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[37] *General Motors Corp. v. District of Columbia*, 380 U.S. 553, 559 (1965).

[38] *Cf., e.g., Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959) (state had burden to justify law regulating mudguards on trucks, which was inconsistent with the laws of a great many other states).

[39] Indeed, UDITPA provides the language utilized in most state statutes that permits deviations from state laws: "if the allocation and apportionment provisions of [the state statutes] do not fairly represent the extent of the taxpayer's business activity in

meled discretion poses a substantial risk of arbitrary results. Thus, the Court should consider whether states are applying their statutes in an inconsistent manner, including: whether the state has varied the formula applied to a taxpayer from year to year, so as to achieve markedly different results; whether the tax base derived through apportionment varies substantially from year to year, without similar variations in the company's operations or revenues;[40] and whether the state has "evaluate[d] the entire enterprise in a consistent manner," including allowing taxpayers the option of combined returns and combined apportionment if the state has included dividend income in the taxpayer's tax base.[41]

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this state," the income apportionment method may be altered. *See, e.g.*, Maryland, Md. Code Ann. Tax-General § 10-402(a) (1988 & Supp. 1991); Montana, Mont. Code Ann. § 15-31-312 (1991); New Jersey, N.J. Stat. Ann. § 54:10A-8 (West 1986); Oregon, Or. Rev. Stat. § 314.670 (1991).

Consistently with these provisions, state courts have affirmed that "[a] tax authority may modify past practices to the disadvantage of a taxpayer if it is determined that the former practice was incorrect . . . even though it may result in the subjection of identical transactions occurring at different times to different tax treatment." *Amerada Hess Corp. v. Conrad*, 410 N.W. 2d 124, 134 (N.D. 1987). *See, e.g., True v. Heitkamp*, 470 N.W. 2d 582 (N.D. 1991); *Twentieth Century-Fox Film Corp. v. Department of Revenue*, 700 P.2d 1035 (Or. 1985).

Some courts have acknowledged that if deviations from taxing statutes are permitted on a case-by-case basis, however, "[u]niformity would suffer because of the different attitudes of tax administrators both within [the state] and among all UDITPA states. Differing standards for different years and in the several states are almost certain to obtain." *Id.* at 1041. As a result, some state courts are requiring that modifications be made only through regulation. *See, e.g., Fort Howard Paper Co. v. Oklahoma Tax Comm'n*, 792 P.2d 87 (Okla. App. 1989); *CBS Inc. v. Comptroller of the Treasury*, 575 A.2d 324 (Md. 1990).

[40] *See Norfolk & Western R. Co. v. Missouri State Tax Comm'n*, 390 U.S. at 322.

[41] *Mobil*, 445 U.S. at 461 (Stevens, J., dissenting). *See Container*, 463 U.S. at 168 n.5.

In sum, if this Court were to upset its settled precedent and expand state taxing jurisdiction, it should reevaluate whether its remaining precedents afford interstate commerce sufficient protection against undue and discriminatory state taxation.

CONCLUSION

The Court should retain *ASARCO* and *Woolworth* and not abandon the unitary business principle.

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April 10, 1992

No. 91-615

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL, INC., as successor-in-interest to The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The Supreme Court Of New Jersey

BRIEF OF ALABAMA, ARIZONA, ARKANSAS, COLORADO, DISTRICT OF COLUMBIA, FLORIDA, GEORGIA, GUAM, HAWAII, INDIANA, KENTUCKY, LOUISIANA, MICHIGAN, MISSISSIPPI, MONTANA, NEBRASKA, NEVADA, NEW MEXICO, NEW YORK, NORTH CAROLINA, NORTH DAKOTA, OHIO, OKLAHOMA, SOUTH DAKOTA, TEXAS, UTAH, VIRGIN ISLANDS, VIRGINIA, WASHINGTON, WEST VIRGINIA, WISCONSIN, AND WYOMING AS AMICI CURIAE IN SUPPORT OF RESPONDENT

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTRODUCTORY STATEMENT	1
INTEREST OF AMICI CURIAE	1
SUMMARY OF ARGUMENT	2
ARGUMENT	4
The Court should reaffirm *Chevron Oil* as the test for determining the retroactivity of United States Supreme Court decisions resolving challenges to state tax statutes on federal grounds	4
A. Supreme Court retroactivity precedent in state tax cases	7
B. Application of *Chevron Oil* to state tax cases	12
(1) State Tax Upheld or Invalidated Based on Established Supreme Court Precedent	13
(2) State Tax Upheld or Invalidated by Overruling Prior Decisions	15
(3) State Tax Upheld or Invalidated by Resolution of Issues of First Impression	18
CONCLUSION	23

TABLE OF AUTHORITIES

Page

CASES:

American Trucking Ass'ns v. Conway, 152 Vt. 383, 566 A.2d 1335 (1989) 11

American Trucking Ass'ns v. Smith, 110 S. Ct. 2323 (1990) 3, 8, 11, 14

Arizona Governing Comm. for Tax Deferred Annuity and Deferred Compensation Plans v. Norris, 463 U.S. 1073 (1983) 7

ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) 1, 16, 17

Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) 14, 15

Ashland Oil, Inc. v. Caryl, 110 S.Ct. 3202 (1990) 14

Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) 10

Barker v. Kansas, 249 Kan. 186, 815 P.2d 46 (1991), *cert. granted*, 60 U.S.L.W. 3402 (U.S. Dec. 2, 1991) (No. 91-611) 2, 5

Bass v. South Carolina, 302 S.C. 250, 395 S.E.2d 171 (1991), *vacated and remanded*, 111 S.Ct. 2881 (1991), *aff'd*, No. 23216, 1992 SC LEXIS 22 (S.C. S.Ct. Jan. 27, 1992) 9

Cambridge State Bank v. Roemer, 457 N.W.2d 716 (Minn. 1990), *vacated and remanded sub nom. Norwest Bank Duluth, N.A. v. James*, 111 S.Ct. 2881 (1991), *reaffirmed in part and remanded sub nom. Cambridge State Bank v. James*, No. CO-89-2097, 1992 Minn. LEXIS 37 (Minn. S.Ct. Feb. 14, 1992) 9

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) ..... *passim*

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 16

TABLE OF AUTHORITIES – Continued

Page

Davis v. Michigan Dep't of Treasury, 489 U.S. 803 (1989) 3, 5, 7, 19

Exxon Corp. v. Hunt, 109 N.J. 110, 534 A.2d 1 (1987) 12

F. W. Woolworth Co. v. Tax'n and Revenue Dep't, 458 U.S. 354 (1982) 1, 16, 17

First of McAlester Corp. v. Oklahoma Tax Comm'n, 709 P.2d 1026 (Okla. 1985) 12

Fountain v. Fountain, 214 Va. 347, 200 S.E.2d 513 (1973), *cert. denied*, 416 U.S. 939 (1974) 12

Harper v. Virginia Dep't of Tax'n, 241 Va. 232, 401 S.E.2d 868 (1991), *vacated and remanded*, 59 U.S.L.W. 3864 (U.S. June 24, 1991), *aff'd*, 242 Va. 322, 410 S.Ed.2d 629 (1991), *petition for cert. filed*, 60 U.S.L.W. 3406 (U.S. Nov. 15, 1991) (No. 91-794) 5, 9

James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439 (1991) ..... *passim*

Kuhn v. Colorado, 817 P.2d 101 (Colo. 1991), *petition for cert. filed*, 60 U.S.L.W. 3481 (U.S. Dec. 13, 1991) (No. 91-980) 5

Lemon v. Kurtzman, 411 U.S. 192 (1973) 11

Lewy v. Virginia Dep't of Tax'n, 241 Va. 232, 401 S.E.2d 868 (1991), *vacated and remanded*, 59 U.S.L.W. 3864 (U.S. June 24, 1991), *aff'd*, 242 Va. 322, 410 S.E.2d 629 (1991), *petition for cert. filed*, 60 U.S.L.W. 3446 (U.S. Nov. 27, 1991) (No. 91-882) 5

McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco, 110 S.Ct. 2238 (1990) 7, 8

National Can Corp. v. Dep't of Revenue, 109 Wash. 2d 878, 749 P.2d 1286, *cert. denied*, 486 U.S. 1040 (1988) 11

TABLE OF AUTHORITIES – Continued

Page

North Dakota v. Quill Corp., 470 N.W.2d 203 (N.D. 1991), *cert. granted*, 112 S.Ct. 49 (1991) (No. 91-194) 2

Opinion of Justices, 131 N.H. 644, 557 A.2d 1364 (N.H. 1989) 11

Pledger v. Bosnick, 306 Ark. 45, 811 S.W.2d 286 (1991), *petition for cert. filed*, 60 U.S.L.W. 3173 (U.S. Sept. 3, 1991) (No. 91-375) 5

Salorio v. Glaser, 93 N.J. 447, 461 A.2d 1100, *cert. denied*, 464 U.S. 993 (1983) 12

Sheehy v. Montana, 820 P.2d 1257 (Mont. 1991), *petition for cert. filed*, 60 U.S.L.W. 3675 (U.S. March 9, 1992) (No. 91-1473) 5

Swanson v. North Carolina, 330 N.C. 390, 410 S.Ed.2d 490 (1991), *petition for cert. filed*, 60 U.S.L.W. 3655 (U.S. March 4, 1992) (No. 91-1436) 5

Swanson v. Powers, 937 F.2d 965 (4th Cir. 1991), *cert. denied*, 60 U.S.L.W. 3478 (U.S. Jan. 13, 1992) 3

Teague v. Lane, 489 U.S. 288 (1989) 10

United States v. Johnson, 457 U.S. 537 (1982) 3

CONSTITUTIONS AND STATUTES:

Fla. Const. Art. V, § 3 (10) 20

U.S. Const. Art. III, § 2 20

4 U.S.C. § 111 7

28 U.S.C. § 1257 7

MISCELLANEOUS:

U.S. Sup. Ct. R. 37 1

W. Hellerstein, *Preliminary Reflections on McKesson and American Trucking Associations*, 48 Tax Notes No. 3, 325 (July 16, 1990) 5

INTRODUCTORY STATEMENT

Pursuant to United States Supreme Court Rule 37, the signatory States, the District of Columbia, the Virgin Islands and Guam submit this brief as *amici curiae* supporting Respondent in response to the Court's March 11, 1992 order inviting the views of *amici curiae* on the following issues:

1) Should the court overrule *ASARCO v. Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F. W. Woolworth Company v. Taxation and Revenue Department*, 458 U.S. 354 (1982)?

2) If *ASARCO* and *Woolworth* were overruled, should this decision apply retroactively?

3) If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

Because of its complexity and nationwide importance, this brief addresses only the second issue.

INTEREST OF *AMICI CURIAE*

The States, as sovereigns that must function effectively in our federal system, have a vital interest in the rules governing the retroactivity of United States Supreme Court decisions affecting state taxation. To a greater extent than even individuals and businesses, states must forecast and budget limited revenues in advance.

This case, like several other cases currently before the Court,[1] is yet another example of how a single United States Supreme Court decision can profoundly affect States, individuals and businesses throughout the country. *Amici curiae*, therefore, have a direct and abiding interest in this case.

SUMMARY OF ARGUMENT

Because the States, as sovereigns, are responsible for delivering services to all their citizens, United States Supreme Court decisions affecting state taxation have a unique potential to affect directly virtually every individual and business in the nation, whether as a taxpayer or as a recipient of state services. This potential impact mandates retention of the equitable analysis articulated in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (*"Chevron Oil"*) to determine the retroactivity of Supreme Court decisions affecting state taxation. The equitable analysis articulated in *Chevron Oil* is the only test that is fair to States and taxpayers alike.

Just as the Court has a unique responsibility to "fess up and change" its opinion when it discovers an erroneous limitation on legitimate state taxation,[2] the Court

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[1] The question of retroactivity also has been explicitly raised by the Court in the following cases: *Quill Corp. v. North Dakota*, No. 91-194 (argued Jan. 22, 1992); *Barker v. Kansas*, No. 91-611 (argued March 3, 1992). *See also* note 3 *infra*.

[2] *See* Transcript of Oral Argument in *Quill Corp. v. North Dakota*, No. 91-194 at p. 19 (Jan. 22, 1992) (comment from Court).

also has a unique responsibility to mitigate the impact of opinions that change the rules upon which States and taxpayers have relied in planning their budgets and making commitments. Neither States nor taxpayers should be penalized for "fail[ing] to predict how the Supreme Court would rule." *Swanson v. Powers*, 937 F.2d 965, 971 (4th Cir. 1991), *cert. denied*, 60 U.S.L.W. 3478 (U.S. Jan. 13, 1992) (declining to impose civil liability on state tax official for enforcing presumptively valid state law taxing federal civil retirement pensions prior to *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989)).

As recently as 1982, the Court stated unequivocally that "all questions of civil retroactivity continue to be governed by the standard enunciated in *Chevron Oil Co. v. Huson*." *United States v. Johnson*, 457 U.S. 537, 563 (1982). In 1990, a plurality of the Court confirmed this standard. *American Trucking Ass'ns v. Smith*, 110 S. Ct. 2323 (1990). The 1991 decision in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), did not overrule *Chevron Oil*. The net result of the splintered voting in *Beam* is that only Justices Blackmun, Marshall and Scalia reject the application of a *Chevron Oil* analysis in a case such as the one now before the Court.

The three-part *Chevron Oil* test allows the Court the flexibility needed to perform the vital task of interpreting the federal statutory and constitutional limitations affecting state taxation. Pursuant to *Chevron Oil*, the retroactivity of a Supreme Court decision depends on whether (1) "the decision . . . establish[es] a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first

impression whose resolution was not clearly foreshadowed"; (2) "retrospective operation will further or retard" the operation of the rule in question; and (3) retroactive application would result in inequity, injustice or hardship. *Chevron Oil*, 404 U.S. at 106-07 (citations omitted).

By requiring consideration of the existing legal landscape, the impact of retroactivity and the equities, the three-part *Chevron Oil* test facilitates the smooth transitions in the law that are so essential when the Court modifies or announces new constitutional or statutory interpretations affecting state taxation. Otherwise, the draconian prospect of full retroactive liability – whether for refunds or additional taxes – may impede the development of sound precedent. Only by deliberately and explicitly considering the equitable *Chevron Oil* factors can the Court develop sound precedent in a way that treats fairly all the vital interests affected.

ARGUMENT

THE COURT SHOULD REAFFIRM *CHEVRON OIL* AS THE TEST FOR DETERMINING THE RETROACTIVITY OF UNITED STATES SUPREME COURT DECISIONS RESOLVING CHALLENGES TO STATE TAX STATUTES ON FEDERAL GROUNDS.

The result in a case challenging a state tax statute on federal grounds radiates far beyond the parties before the Court. The potential effect is evidenced by the amount of litigation generated by a single United States Supreme Court decision invalidating a tax on federal constitutional

grounds.[3] The vast reach of such decisions creates a situation in which the revenues of a State are in constant jeopardy, thus potentially affecting every citizen who contributes to or benefits from the revenues. Justice O'Connor, writing for the three dissenting Justices in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), recognized this impact on the citizens of a State:

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[3] The decision of the Court three years ago in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), generated additional litigation involving as much as $2.2 billion in refund claims in at least the following twenty-four States: Alabama, Arizona, Arkansas, Colorado, Georgia, Iowa, Kansas, Kentucky, Louisiana, Maryland, Michigan, Mississippi, Missouri, Montana, New Mexico, New York, North Carolina, Oklahoma, Oregon, South Carolina, Utah, Virginia, West Virginia and Wisconsin. *See* W. Hellerstein, *Preliminary Reflections on McKesson and American Trucking Associations*, 48 Tax Notes No. 3, 325, 326 (July 16, 1990). Much of this litigation has yet to be resolved in the state courts, and seven cases that originated in state courts are presently pending in this Court. *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (1991), *petition for cert. filed*, 60 U.S.L.W. 3173 (U.S. Sept. 3, 1991) (No. 91-375); *Kuhn v. Colorado*, 817 P.2d 101 (Colo. 1991), *petition for cert. filed*, 60 U.S.L.W. 3481 (U.S. Dec. 13, 1991) (No. 91-980); *Barker v. Kansas*, 249 Kan. 186, 815 P.2d 46 (1991), *cert. granted*, 60 U.S.L.W. 3402 (U.S. Dec. 2, 1991) (No. 91-611); *Sheehy v. Montana*, 820 P. 2d 1257 (1991), *petition for cert. filed*, 60 U.S.L.W. 3675 (U.S. March 9, 1992) (No. 91-1473); *Swanson v. North Carolina*, 330 N.C. 390, 410 S.E.2d 490 (1991), *petition for cert. filed*, 60 U.S.L.W. 3655 (U.S. March 4, 1992) (No. 91-1436); *Harper v. Virginia Dep't of Tax'n*, 242 Va. 322, 410 S.E.2d 629 (1991), *petition for cert. filed*, 60 U.S.L.W. 3406 (U.S. Nov. 15, 1991) (No. 91-794); *Lewy v. Virginia Dep't of Tax'n*, 242 Va. 322, 410 S.E.2d 629 (1991), *petition for cert. filed*, 60 U.S.L.W. 3446 (U.S. Nov. 27, 1991) (No. 91-882).

> Georgia collected in good faith what was at the time a constitutional tax. The Court now subjects the State to potentially devastating liability without fair warning. This burden will fall not on some corrupt state government, but ultimately on the blameless and unexpecting citizens of Georgia in the form of higher taxes and reduced benefits.

111 S. Ct. at 2456 (O'Connor, J., dissenting).

Because of the litigation generated in other States by a Supreme Court decision invalidating a single State's tax, such a decision goes further than even the dissenting Justices acknowledged in *Beam* and, in a very real sense, has the potential for affecting directly every citizen of the United States. The citizens will be affected in two quite distinct ways, through either an increase in their state taxes or a reduction in state services. And, with reductions in state services, those who will suffer the most will be those who are least able to provide fully for their own needs.

Retroactive application of a Supreme Court state tax decision may affect citizens in yet another way. The retroactive application of a decision *validating* a state tax has the potential for imposing a back-tax liability on numerous "unexpecting" taxpayers.

A critical need exists for this Court to establish a clear and fair standard for determining when Supreme Court decisions validating or invalidating a state tax statute will have retroactive effect. It is the position of *amici curiae* that, regardless of the retroactivity standard in other types of litigation, in cases challenging a state tax

on federal grounds, the Court should recognize the massive impact of its decisions and should apply the test announced in *Chevron Oil*. The *Chevron Oil* test, by recognizing the legitimate reliance interests of all parties, provides an equitable solution to the problems created by unanticipated changes to the constitutional landscape.[4]

A. Supreme Court Retroactivity Precedent in Review of State Tax Cases

In the past two years, the Court has decided three cases concerning the question of the retroactivity of Supreme Court decisions invalidating a state tax: *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991) (*"Beam"*); *McKesson Corp. v. Div'n of Alcoholic Beverages and Tobacco*, 110 S. Ct. 2238 (1990) (*"McKesson"*); and

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[4] The references in this brief to changes in Supreme Court precedent interpreting the federal Constitution apply equally to Supreme Court precedent interpreting the language and intent of federal statutes that have the broad reach of a federal constitutional decision. *See, e.g., Arizona Governing Comm. for Tax Deferred Annuity and Deferred Compensation Plans v. Norris*, 463 U.S. 1073 (1983) (State's payment of retirement benefits constituted "discrimination" under Title VII of Civil Rights Act of 1964 but holding not to be applied retroactively). In both federal statutory and constitutional cases, the question is one of federal law within the jurisdiction of the Supreme Court. 28 U.S.C. § 1257. Federal statutes often are enacted to provide statutory guidance on basic constitutional principles, and the Court's interpretation of statutory terms, such as "discrimination," derives from and incorporates these constitutional principles. *See Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 813 (1989) (principle of nondiscrimination in 4 U.S.C. § 111 derives from constitutional doctrine of intergovernmental tax immunity).

American Trucking Ass'ns v. Smith, 110 S. Ct. 2323 (1990) ("*ATA v. Smith*").

Of the three decisions, only *McKesson* received the support of a majority of the Court. The rule announced in *McKesson* is straightforward. *McKesson* establishes that, absent a pre-deprivation remedy available to the taxpayer, prospective-only application of a Supreme Court decision is not adequate where, on the facts, it is entirely foreseeable at the time of enactment of a state tax statute that the tax in question will, when challenged, be found unconstitutional. 110 S. Ct. at 2251, 2255. *McKesson* concerns the due process remedial obligations imposed on state governments in cases where the State could not have relied in good faith on the validity of its statutory enactment. Such a case is of only marginal relevance to the retroactivity issue now before the Court. Here, by contrast, the issue is closer to the questions presented in *ATA v. Smith* and in *Beam*.

In *ATA v. Smith*, the Court divided four to four on the proper test to apply in determining retroactivity. Four Justices supported the *Chevron Oil* test, 110 S. Ct. at 2327-43; four dissenting Justices would apply the same substantive rule to all cases pending on review at the time of the decision announcing the new rule, 110 S. Ct. at 2345-56; and one concurring Justice would hold all Supreme Court constitutional decisions retroactive unless he disagreed with the particular new rule of law being announced, 110 S. Ct. at 2343-45.

Since *ATA v. Smith*, when state courts have been required to determine the retroactivity of a Supreme Court decision, most have followed the plurality in *ATA*

v. Smith and applied the *Chevron Oil* test. *See, e.g., Harper v. Virginia Dep't of Tax'n*, 241 Va. 232, 401 S.E.2d 868 (1991); *Bass v. South Carolina*, 302 S.C. 250, 395 S.E.2d 171 (S.C. 1991); *Cambridge State Bank v. Roemer*, 457 N.W.2d 716 (Minn. 1990).[5] The issue was presented to the Court again the following term in *Beam*, and state courts awaited clearer guidance.

Five opinions were written in *Beam*, none of which commanded a majority of the Court. The three dissenting Justices in *Beam* are solidly behind the application of *Chevron Oil* to controversies involving the retroactivity of cases of the sort now before this Court. As Justice O'Connor stated:

> If the Court decides, in the context of a civil case or controversy, to change the law, it must make the subsequent determination whether the new law or the old is to apply to conduct occurring before the law-changing decision. *Chevron Oil* describes our long-established procedure for making this inquiry.

111 S. Ct. at 2451.

In sharp contrast to the view expressed by Justice O'Connor in *Beam* is the view expressed by Justice Blackmun, in which Justices Marshall and Scalia joined. The position of these three Justices is that the Supreme Court lacks the authority to apply its constitutional decisions other than retroactively, regardless of whether the decision is founded on established precedent or on a new rule

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[5] These three cases were reviewed by Supreme Court. After the decision in *Beam*, the Court vacated and remanded the cases to the state supreme courts for further consideration in light of *Beam*. 59 U.S.L.W. 3864 (U.S. June 24, 1991).

of law. *Beam*, 111 S. Ct. at 2450 (Court fulfills its "judicial responsibility by requiring retroactive application of each new rule we announce") (Blackmun, J., concurring).[6] Under this view, if a State imposes a tax in reliance on existing precedent and the Supreme Court overrules that precedent, the new rule nevertheless applies retroactively, implying that the State was unjustified in relying on existing precedent. It follows then, ironically, that if a State imposes a new tax that violates clear existing precedent and the Supreme Court overrules that precedent, the new rule applies retroactively, implying that the State was justified in imposing a tax in violation of then-existing Supreme Court precedent.

Beam sent another unsettling message to States and to taxpayers. Justice Souter, in his opinion in which Justice Stevens joined, stated that the language remanding *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) for consideration of refund issues not addressed by the state courts, including a pass-through defense raised by the State, could be "fairly read" as an *implicit* ruling by the Court that *Bacchus* applied retroactively.[7] 111 S. Ct. at 2445.

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[6] However, even in the criminal context, this Court has not accepted full retroactivity of all Supreme Court decisions. For example, a prisoner on a habeas petition is not afforded the retroactive benefit of a "new rule of law." *See, e.g., Teague v. Lane*, 489 U.S. 288 (1989).

[7] The pass-through defense was an element of the State's argument in *Bacchus* that any decision in favor of the appellants would apply prospectively only under *Chevron Oil* since a refund would constitute a windfall and unjust enrichment of appellants at the expense of the general public. Brief for Appellee at 19-22. A remand to consider such remedial issues could, in fact, be fairly read as the Court's *not* determining the retroactivity issue in *Bacchus*.

Justice Souter further stated that "[b]ecause the *Bacchus* opinion did not reserve the question whether its holding should be applied to the parties before it, . . . it is properly understood to have followed the normal rule of retroactive application in civil cases." 111 S. Ct. at 2445.

This presumption of retroactivity from silence, even where the issue is never raised, briefed or argued in the Supreme Court, has created additional problems for both States and taxpayers. The actual litigants in a state tax case may have no interest in whether the ruling is prospective or retroactive and may present no argument to the Court on the issue. However, other States and other taxpayers who may be affected by the ruling must now find a way to present their views to the Court or risk being encompassed within the ruling without an opportunity to be heard.

Since the decision in *Beam*, state courts have continued to struggle with the question of the retroactivity of Supreme Court decisions in state tax cases.[8] *Amici curiae*

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[8] Prior to *ATA v. Smith* and *Beam*, many state courts applied the equitable principles enunciated in *Chevron Oil* and in *Lemon v. Kurtzman*, 411 U.S. 192 (1973), in determining the retroactivity of both state and United States Supreme Court decisions. State courts have found the *Chevron Oil* test a workable solution to the retroactivity problem. The courts have applied *Chevron Oil* in a reasonable and responsible manner which, depending on the particular facts and circumstances, may result in a holding in favor of the state or in favor of the taxpayer. *See, e.g., American Trucking Ass'ns v. Conway*, 152 Vt. 383, 566 A.2d 1335 (1989) (Supreme Court decision retroactive in this case under *Chevron Oil* because predicted by state case); *Opinion of Justices*, 131 N.H. 644, 557 A.2d 1364 (1989) (state court decision not retroactive because it upset tax practice relied on by taxpayers and State); *National Can Corp. v. Dep't of*

(Continued on following page)

submit that, as discussed below, the retroactivity standard established in *Chevron Oil* is the only viable standard which gives recognition to *stare decisis* yet considers the interests of both States and taxpayers, balances those interests and affords an equitable resolution. *Amici curiae* urge this Court to affirm that, regardless of the retroactivity standard in other types of cases, the *Chevron Oil* test is the proper test for determining the retroactivity of Supreme Court decisions that validate or invalidate a state tax on federal grounds.

B. Application of *Chevron Oil* to State Tax Cases

In most instances, the Supreme Court will determine the validity of a state tax challenged on constitutional grounds on the basis of established Supreme Court precedent. The new decision may build on or add to the body of existing law but not chart a new direction for the

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Revenue, 109 Wash. 2d 878, 749 P.2d 1286, *cert. denied*, 486 U.S. 1040 (1988) (Supreme Court decision that invalidated tax repeatedly upheld by state court not retroactive; state justified in relying on earlier decisions); *First of McAlester Corp. v. Oklahoma Tax Comm'n*, 709 P.2d 1026 (Okla. 1985) (Supreme Court decision invalidating tax on interest income not retroactive because of lack of foreseeability); *Exxon Corp. v. Hunt*, 109 N.J. 110, 534 A.2d 1 (1987) (Supreme Court decision retroactive because holding not unpredictable); *Salorio v. Glaser*, 93 N.J. 447, 461 A.2d 1100, *cert. denied*, 464 U.S. 993 (1983) (decision not retroactive based on justifiable reliance on long-standing unchallenged statute). *See also Fountain v. Fountain*, 214 Va. 347, 200 S.E.2d 513 (1973), *cert. denied*, 416 U.S. 939 (1974) (decision abolishing interspousal immunity not retroactive because persons justifiably relied on existing state of law).

Court. These decisions will always be retroactive. But constitutional doctrines are not immutable. Particularly in the tax area, changing economic realities necessitate changes in constitutional interpretations. Accordingly, the Court may be called on to reconsider an issue in light of an altered economic background. The result may be a holding that the tax is constitutional or unconstitutional, a holding that in turn overrules an existing Supreme Court precedent directing the opposite result. The Court also may be presented with a new question that reference to the existing body of constitutional precedent does not answer. The result will be a holding that the challenged tax is constitutional or unconstitutional as an issue of first impression.

While any of the above resolutions of a case may generate additional litigation in other States, this result is especially likely if the decision is premised either on a prior overruling decision or on an issue of first impression. The change in the constitutional order serves as an incentive for numerous additional parties to institute challenges to similar tax statutes in other States.

The question now before this Court is how can the Court fairly accommodate the varying circumstances and the interests of all parties affected by its decisions. *Chevron Oil* provides this flexible and equitable standard in each of the permutations described below.

(1) State Tax Upheld or Invalidated Based on Established Supreme Court Precedent

When a challenged tax is ruled constitutional based on established Supreme Court precedent, logic and

fairness support full retroactive application of the decision. A State should be able to collect and rely on revenues generated by a tax that conforms to existing Supreme Court precedent. Indeed, States can plan and operate effectively only by assuming that such taxes are valid. A *Chevron Oil* analysis fully comports with the retroactive application of Supreme Court decisions validating a state tax on the basis of existing precedent.

Likewise, a *Chevron Oil* analysis produces a fair result when a state tax statute is held unconstitutional based on existing Supreme Court precedent. A State cannot justifiably rely on revenues generated by a statute that clearly conflicts with established Supreme Court precedent. The ease of application of *Chevron Oil* under such facts is evident in the recent per curiam decision in *Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202 (1990) ("*Ashland Oil*").

In *Ashland Oil*, the taxpayer challenged the same state tax challenged by another taxpayer in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984). The Court decided *Armco* while *Ashland Oil* was pending in state court. In a decision that pre-dated *ATA v. Smith*, the state supreme court held that the State could collect the taxes from Ashland Oil for the years preceding *Armco* because *Armco* was not retroactive. *Ashland Oil, Inc. v. Rose*, 350 S.E.2d 531 (W. Va. 1986).

In a per curiam opinion, this Court reversed. The Court held that, under either the dissent or the plurality in *ATA v. Smith*, *Armco* was retroactive. Under the dissent, *Armco* was retroactive because "constitutional decisions apply retroactively to all cases on direct review." 110 S. Ct. at 3204 (citing *ATA v. Smith*, 110 S. Ct. at 2349) (Stevens, J., dissenting). Under the plurality in *ATA v. Smith*, *Armco* applied retroactively because it "fail[ed] to satisfy the first prong of the plurality's test for determining retroactivity" under *Chevron Oil*. 110 S. Ct. at 3204. While *Armco* contributed to the Court's Commerce Clause jurisprudence, it did not overturn established precedent or decide an issue of first impression. *Id.* at 3205.

If all decisions of the Supreme Court fit neatly within the established precedent category, it would no doubt make little difference whether retroactivity were based on *Chevron Oil* or on a broad principle that all Supreme Court decisions apply retroactively. But this is not the case. The *Chevron Oil* test recognizes that the Supreme Court also overrules precedent and decides new issues in the absence of precedent that would preordain a specific result.

(2) State Tax Upheld or Invalidated by Overruling Prior Decisions

The view that all decisions of the Supreme Court are retroactive produces a harsh and unjust result when a tax is declared constitutional or unconstitutional because clear Supreme Court precedent is overruled. In the latter case, the message is that a State cannot presume that its statutes, implemented in good faith reliance on clear existing Supreme Court precedent, are constitutional. Thus, a State cannot plan, budget or spend in reliance on collected or anticipated revenues. Likewise, in the former case, taxpayers cannot rely on having satisfied their tax liability based on existing Supreme Court precedent. The inequity in either of these results is obvious.

Certainly taxpayers are justified in challenging state taxes by arguing that the precedent validating the tax should be overruled. But the interests of States and taxpayers in finality and predictability cannot be ignored. Future relief is incentive enough for the parties when the Court overrules a prior decision on which the parties might reasonably have relied. In the appropriate case, *Chevron Oil* permits future relief only.

The first prong of *Chevron Oil* directs the Court to determine whether the decision establishes a new principle of law "by overruling *clear* past precedent on which litigants may have *relied*." *Chevron Oil*, 404 U.S. at 106 (emphasis added). By incorporating "clear" past precedent and "reliance" into the test, *Chevron Oil* avoids a rigid result which would require prospectivity whenever the Court overrules a prior decision. Rather, *Chevron Oil* allows the Court to view the constitutional issue in its full historical perspective, considering whether the overruled decision may have been narrowed or questioned over the years to the extent that it contains little validity. In the instant case, as argued by New Jersey, *ASARCO* and *Woolworth* did not represent clear past precedent on which the taxpayer could have relied. First, the taxable transaction at issue predated *ASARCO* and *Woolworth*. Second, state courts had interpreted those decisions in various, and often conflicting, ways and later Supreme Court decisions called into question the principle *ASARCO* and *Woolworth* apparently represented. *See Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). It is precisely in circumstances such as those presented here that the *Chevron Oil* test can accommodate both an overruling decision and a holding of retroactivity.

For a party to obtain prospective-only application of the new rule of law under *Chevron Oil*, he must have been *justified* in relying on the old rule and the new rule must overrule "clear" past precedent. Thus, an "overruling" decision need not in all instances create a new rule of law; reliance on the old rule may not have been justified.[9]

The equity in the application of *Chevron Oil* when the Court overrules a clear prior decision that would have validated the tax is apparent. States may impose taxes and plan expenditures in reliance on unimpaired Supreme Court precedent without fear that an overruling decision of the Court will suddenly and without warning remove these revenues from state treasuries and affect the States' ability to continue to provide critical governmental services. Before *Beam*, most States assumed that such was the law. The full impact on States of not being able to operate in this manner cannot be overstated.

But the reverse can happen, too. If the Supreme Court overrules a precedent under which a state tax statute would have been unconstitutional, it is the taxpayer whose reliance interest will be unsettled by a fully retroactive application of the decision. If the decision of

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[9] Even should the Court determine that *ASARCO* and *Woolworth* represented clear past precedent on which the appellant may have relied, application of the remaining two prongs of *Chevron Oil* could nevertheless result in a holding of retroactivity in this case. The harm to New Jersey and its citizens by prospective-only application of the new rule is a crucial factor in this case. And the financial impact on other States is not known.

the Supreme Court under such circumstances is retroactive, a State could impose a back-tax liability on taxpayers. Included within the class affected are not only the litigants in the case, but also taxpayers within the State and taxpayers in other States. In some instances, retroactive taxation may be a fair result; in other instances, it clearly will not be. The application of *Chevron Oil* provides the flexibility needed for courts, on a case-by-case basis, to reach an equitable result and to avoid the prejudice arising from decisions that could not fairly have been anticipated.

It may be, of course, that taxpayers in this situation would be protected by other constitutional doctrines that would limit the ability of the State retroactively to assess taxes based on events that occurred in prior years. Importantly, however, the potential application of such doctrines reinforces the point sought to be made. What is sauce for the goose should be sauce for the gander. If constitutional doctrines are in place that would protect individual taxpayers in such a case, the principle on which these doctrines are based is precisely the principle suggested here: it is unfair to upset settled expectations by revisiting financial arrangements thought to be over and done with.

(3) State Tax Upheld or Invalidated by Resolution of Issues of First Impression

As discussed above, *Chevron Oil* accommodates a situation in which the Court, by overruling clear past precedent, effects a dramatic change in the constitutional order by replacing existing law with a new rule of law.

Chevron Oil also accommodates a situation in which a new rule of law first emerges on the constitutional scene. By allowing the Court to apply such a decision prospectively only, *Chevron Oil* resolves the dilemma in a way that is fair both to States and to taxpayers.

A case of first impression invalidating a state tax on federal constitutional grounds has a potentially disastrous effect on other States with similar statutes.[10] If Supreme Court precedent exists on the issue raised, a State may analyze and interpret the precedent to reach a reasonable conclusion on the constitutionality of its statute. If the precedent may arguably support either a holding of constitutionality or unconstitutionality, the State has some forewarning that its revenues may be at risk.

The resolution of an issue of first impression provides no forewarning. And, as in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989) ("*Davis*") and the cases spawned by *Davis*, the challenge may be to numerous state statutes that have been on the books and unchallenged for many years. Such decisions come as a bolt from the blue to the States. Absent a retroactivity standard that takes into account the reliance interests of States in the validity of longstanding and unchallenged tax statutes, nothing less than an express ruling of constitutionality by this Court will protect the revenues and permit the States to plan and budget for the present and the future. Certainly States are not required to present

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[10] *See* note 3 *supra*, regarding the effect that the ruling on Michigan's tax statute in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), had on other States.

their tax statutes to the Supreme Court for review and approval in order to obtain fiscal stability.[11]

Limiting the effect of a new rule of law in a case of first impression to prospective application only is not unfair to taxpayers. Reliance is the critical factor in the doctrine of retroactivity. A taxpayer cannot argue that he relied on the unconstitutionality of a tax when there is no Supreme Court precedent foreshadowing that result. If the taxpayer succeeds in his challenge and the Court adopts a new legal rule, the taxpayer will receive the future benefit of the new rule. Equity requires no more.[12]

The nature of the harm suffered by the taxpayer is an appropriate factor in determining where the equities lie in a case of unforeseen constitutional developments in state tax litigation. The taxpayers are not harmed because the State denied them a personal constitutional right,

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[11] Indeed, unlike provisions in some state constitutions, the federal Constitution would preclude a State's seeking such review before enacting the tax as constituting a request for an advisory opinion. *Compare* U.S. Const. Art. III, § 2 (judicial power extends to cases and controversies) *with* Fla. Const. Art. V, § 3(10) (1980) (Attorney General of Florida may request advisory opinion of state supreme court on Florida constitutional questions).

[12] When the Supreme Court invalidates a state tax statute, prospective application alone has a significant impact on the states affected by the change in the law. States must analyze their tax systems to determine whether they comply with the new rule and may need to amend their statutes. Such amendments often entail the expense of calling a special session of the State's legislature, and the necessary amendments for future compliance often result in a loss of anticipated and already budgeted revenues.

such as freedom from an unreasonable search and seizure or freedom from cruel and unusual punishment. They are "harmed" because a State innocently failed to anticipate a dramatic shift in the Court's interpretation of federal statutory and constitutional principles regarding the State's ability to impose a legitimate state tax on its citizens. Balancing this alleged harm against the very real harm that retroactive application may impose on the remainder of the tax-paying community and on those citizens who benefit from services provided from previously imposed taxes, prospective relief is a fully adequate remedy.

When a taxpayer challenges a state tax statute, he is in effect asserting a challenge on behalf of every similarly situated taxpayer in the nation. His challenge if successful subjects the revenues of all of the States to risk; his challenge if unsuccessful subjects the income of all similarly situated taxpayers to additional tax liability. It is this effect that *amici curiae* urge this Court to avoid by reaffirming its adherence to the *Chevron Oil* standard for determining when Supreme Court decisions validating or invalidating state taxes will apply retroactively. The Court should not be in a position in which it is reluctant to overrule prior precedent or to decide issues of first impression because the retroactive application of such decisions imposes a liability on unsuspecting, and often unrepresented, parties. *Chevron Oil* allows the Court to depart from rigid adherence to past precedent without imposing disruptive and potentially devastating future harm.

The three-part *Chevron Oil* test allows the Court to consider the existing legal landscape, the impact of retroactivity, and the equities before announcing dramatic changes in the federal constitutional and statutory principles governing state taxation of individuals and businesses. The test facilitates a smooth transition from the old rule to the new rule in a manner that is fair to States and taxpayers alike. This is particularly true in a *Davis*-like situation, in which the federal law at issue does not deal with the issue of remedy – prospective or retroactive – at all.

CONCLUSION

For the reasons stated, the Court should reaffirm *Chevron Oil* as the test for determining the retroactivity of United States Supreme Court decisions resolving challenges to state tax statutes on federal grounds.

Respectfully submitted,

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FILED
APR 10 1992
OFFICE OF THE CLERK

(27)

No. 91-615

In The

Supreme Court of the United States

October Term, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The
Supreme Court Of New Jersey

AMICUS CURIAE BRIEF IN SUPPORT OF RESPONDENT, DIRECTOR, DIVISION OF TAXATION, SUBMITTED ON BEHALF OF CHEVRON CORPORATION

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TABLE OF CONTENTS

Page

INTEREST OF AMICUS CURIAE 2

SUMMARY OF ARGUMENT..... 4

ARGUMENT 6

I. INTRODUCTION..... 6

II. MANAGEMENT CONTROL IS NOT AN ESSENTIAL ELEMENT IN DETERMINING WHETHER THE BUSINESS OF A DIVIDEND PAYER IS SUFFICIENTLY INTEGRATED WITH THAT OF THE PAYEE TO ALLOW APPORTIONMENT OF THE DIVIDENDS ... 8

III. APPORTIONABLE BUSINESS INCOME MAY ALSO EXIST IN CERTAIN CIRCUMSTANCES WHERE THERE IS NO UNITARY RELATIONSHIP IN ANY SENSE BETWEEN THE UNDERLYING BUSINESSES OF THE PAYOR AND PAYEE OF DIVIDENDS 13

IV. A PRESUMPTION IN FAVOR OF APPORTIONMENT AVOIDS THE APPLICATION OF ARBITRARY SITUS RULES AND PROMOTES UNIFORMITY..... 16

V. WHERE DIVIDENDS ARE FOUND TO BE APPORTIONABLE BUSINESS INCOME DUE TO THE UNITARY RELATIONSHIP BETWEEN THE PAYOR AND PAYEE, THE PAYEE'S APPORTIONMENT FORMULA SHOULD BE ADJUSTED TO TAKE THE PAYOR'S FACTORS INTO ACCOUNT 19

CONCLUSION 22

TABLE OF AUTHORITIES

Page

CASES

American Telephone & Telegraph Co. v. Wisconsin Department of Revenue, 422 N.W.3d 629 (Wisc., 1988) 19, 21

Appeal of Standard Oil Company of California, CCH Calif. Tax. Rptr. ¶ 400-383 (1983) 3

ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982) ..... *passim*

Bass, Ratcliff & Gretton v. State Tax Commission, 266 U.S. 271 (1924) 21

Butler Bros. v. McColgan, 315 U.S. 501 (1942) . 9, 12, 22

Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983) 9, 14, 21, 22

Exxon Corp v. Department of Revenue of Wisconsin, 447 U.S. 207 (1980) 9

F. W. Woolworth Co. v. Taxation and Revenue Department, 458 U.S. 354 (1982) ..... *passim*

Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980) ..... *passim*

NCR Corporation v. South Carolina Tax Commission, 402 S.E.2d 666 (S.C., 1991) 19

Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039 (Me., 1991) 19

TABLE OF AUTHORITIES – Continued

Page

STATUTES AND CODES

California Revenue & Taxation Code Section 23001 3

RULES AND REGULATIONS

MTC Regulation

Section IV.1.(a) 14

Section IV.1.(c) 14, 15

Section IV.18 20

OTHER AUTHORITIES

Dexter, Taxation of Income from Intangibles of Multistate-Multinational Corporations, 29 Vanderbilt L.Rev. (1976) 401 16

Rudolph, State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups, 25 Tax. L. Rev. 171 (1970) 21

Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985) . *passim*

Section 1(a) 14

Section 1(e) 14

Section 18 20

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On Writ Of Certiorari To The
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AMICUS CURIAE BRIEF IN SUPPORT OF RESPONDENT, DIRECTOR, DIVISION OF TAXATION, SUBMITTED ON BEHALF OF CHEVRON CORPORATION

PRELIMINARY STATEMENT

Pursuant to Rule 37.3 of the Rules of this Court, this amicus curiae brief in support of Respondent is filed with the written consents of the parties, on file with the Clerk of this Court.

INTEREST OF AMICUS CURIAE

In this Court's order of March 11, 1992, the views of amici curiae were invited with respect to three questions raised by the Court.

1. Should this Court overrule *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F. W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

The issues presented are of great importance to Chevron Corporation ("Chevron") and many similarly situated companies. Chevron is an integrated petroleum company, domiciled in California, with operations in each of the fifty states and in more than 100 foreign countries. Chevron conducts its worldwide petroleum business directly, through its domestic and foreign subsidiaries and affiliates, and through partnerships and other joint ventures.[1]

Chevron and its subsidiaries have long received foreign source dividends from foreign affiliates, which are

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[1] Subsidiaries refer to corporations in which Chevron, directly or indirectly, holds more than a 50 percent stock interest. Affiliates refer to corporations in which Chevron, directly or indirectly, holds a 50 percent or less stock interest.

engaged in various aspects of Chevron's unitary petroleum business.[2] Two of these affiliates, Arabian American Oil Company ("Aramco") and P.T. Caltex Pacific Indonesia ("CPI") were engaged in crude oil production in Saudi Arabia and Indonesia, respectively, and constituted major sources of crude oil supplies for Chevron's unitary business. In addition, dividends from these affiliates comprised a major portion of Chevron's worldwide net income. The treatment under the California Bank and Corporation Tax Law (Cal.Rev. & Tax. Code § 23001, et seq.) of the dividends received in 1967 from Aramco and CPI was the subject of a decision rendered by the California State Board of Equalization in which the dividends were held to be apportionable business income under California's version of the Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985) ("UDITPA"). See *Appeal of Standard Oil Company of California*, CCH Calif.Tax Rptr. ¶ 400-383 (1983).

Chevron is presently involved in a litigation in the Superior Court of the State of California for the tax years 1974-1979, which presents questions regarding the proper California tax treatment of the foreign source dividends received by Chevron from Aramco and CPI, both in terms of the apportionable income base and the apportionment formula.

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[2] Because of the absence of a controlling ownership interest, none of the affiliates are included in a combined report for state tax reporting purposes. While intercompany dividends from combined subsidiaries are eliminated, dividends from affiliates are not.

Chevron believes that this Court's decisions in *ASARCO* and *Woolworth* have created confusion in the field of state taxation of income from intangibles – a field in which Chevron has a major interest. This Court should revisit its opinions in *ASARCO* and *Woolworth*. Particularly, it should clarify the distinction between a unitary business relationship for combined reporting purposes and a unitary business connection for purposes of determining whether income is apportionable or not.

SUMMARY OF ARGUMENT

Chevron shares the views of the parties and various amici that *ASARCO* and *Woolworth* need, at a minimum, to be clarified. The cases should not be read to require a unitary business relationship in the combined reporting sense between a dividend payor and payee before a dividend is deemed to be apportionable business income. Majority ownership and control of a dividend payor is not a necessary prerequisite for apportionment. A unitary business relationship can exist between a corporation and its affiliates notwithstanding the absence of management control. For example, where a corporation holds a substantial minority interest in another corporation to obtain a source of supply for its unitary business, there is a functional integration between the entities. Because it assures a source of supply, the minority interest in the affiliate should be viewed as an integral part of the parent's unitary business and dividends paid by the affiliate should be classified as apportionable business income.

Further, the principles that apply in determining the scope of a unitary business, whether conducted by one corporation or by several affiliated corporations, are not the same as those that determine whether a particular item of income received by that business, such as dividends or capital gains, is subject to apportionment. There is no dispute that under certain circumstances, apportionable business income may also be found where there is no unitary relationship between the underlying businesses of the payor and payee of dividends. The classic example is short term working capital investments. A particular item of intangible income should be apportionable if the investment from which it is derived is held as an integral part of the unitary business of the taxpayer, conducted in part in the taxing state.

The rules for determining whether income received is apportionable business or nonapportionable nonbusiness income set forth in UDITPA and the Multistate Tax Commission regulations, including the presumption in favor of an apportionable business income classification, are reasonable and consistent with the Due Process Clause. The cause for uniformity in state income taxation would be well served if this Court were to validate the general approach taken by UDITPA and refrain from adopting an unduly restrictive set of principles that favor the arbitrary attribution of income from intangibles on a commercial domicile or other situs basis.

The unitary enterprise should be treated consistently whether it is conducted through divisions of a single corporation or through subsidiaries and affiliates of a multicorporate group. Where dividends from a subsidiary or affiliate are found to be apportionable business

income because there is a unitary relationship between the underlying businesses of the payor and payee, there should be a correlative adjustment made to the payee's apportionment formula to take into account an appropriate percentage of the factors of the payor which generated the earnings from which the dividends were paid.

ARGUMENT

I. INTRODUCTION

ASARCO and *Woolworth* do not need to be overruled. However, they do need to be clarified. In these decisions, this Court has injected great uncertainty and confusion into state income taxation of multistate and multinational businesses by appearing to endorse at least two novel concepts regarding application of the unitary business principle.

First, the opinions in these cases can be read to require a multistate corporate taxpayer to own and exercise a controlling position in another company in order for dividends or gains derived therefrom to be apportionable. In this respect, this Court has confused the determination of the scope of the unitary business in a multicorporate combined report setting with the determination whether particular items of income received by the unitary business once its scope has been defined, are properly apportioned among the states in which that business is conducted. As this Court recognized in *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 430, n.5 (1980), majority ownership and control

of a payor corporation is not determinative of the latter issue.

Second, *ASARCO* and *Woolworth* have also created confusion because they can be read to require functional integration between the underlying businesses of the payor and payee of dividends before apportionment of the income is permitted. Clearly where functional integration between the operations of affiliated corporations *is* present, as it was in *Mobil*, then apportionment of the intangible income derived by the taxpayer from its interest in the affiliate is appropriate and consistent with the requirements of due process. However, such "functional integration" between affiliated corporations has never been the exclusive basis on which intangible income could be apportioned. So long as the stockholdings from which the income is derived are an integral part of the business operations of the taxpayer conducted in part within the taxing state, the "minimal connection" and "rational relationship" required by due process are present.

ASARCO and *Woolworth* also addressed a third, and conceptually distinct, point by holding that intangible income could not be held to be part of the apportionable income of the taxpayer derived from its business conducted within the taxing jurisdiction merely because it contributed to the "riches" of the corporation and thus provided a source of funds for the conduct of that business. *ASARCO, supra*, 458 U.S. at 326; *F.W. Woolworth Co., supra*, 458 U.S. 354, 363. This Court can correct the two areas of confusion previously discussed without also rejecting the view that the mere generation of wealth by an investment, without any closer relationship between

the investment and the operations of the unitary business of the taxpayer within the taxing state, cannot support apportionment. The widely accepted provisions of UDITPA, which focus on the integral relationship of the shareholdings in question to the conduct of the business of the taxpayer within the taxing jurisdiction, provide a reasonable and constitutional stopping point short of the unprecedented restrictions of "managment control" and "functional integration" suggested by the majority in *ASARCO*. As the dissent in *ASARCO* correctly recognized, "without a well-founded constitutional mandate, [the Court] has straitjacketed the States' ability to develop fair systems of apportionment, prematurely ending the evolutionary process begun by the Uniform Division of Income for Tax Purposes Act and the Multistate Tax Commission." *ASARCO, supra*, 458 U.S. at 349.

II. MANAGEMENT CONTROL IS NOT AN ESSENTIAL ELEMENT IN DETERMINING WHETHER THE BUSINESS OF A DIVIDEND PAYOR IS SUFFICIENTLY INTEGRATED WITH THAT OF THE PAYEE TO ALLOW APPORTIONMENT OF THE DIVIDENDS.

In the state corporate income tax field, there are two distinct but related areas of controversy which frequently arise involving the application of the unitary business principle.

The first concerns whether various divisions of a single corporate entity or of a commonly controlled group of corporations are engaged in a single unitary business, or in two or more separate unitary businesses,

each with its separate apportionment factors and net income determination. *Butler Bros. v. McColgan*, 315 U.S. 501 (1942) and *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207 (1980) are cases which involved the two or more business issue in the context of a single corporation. In this situation, ownership and control are necessarily present.

Although not an issue in the single corporation context, more than 50 percent ownership and control is required by the states that use combined reports to determine the apportionable income of a multicorporate unitary business group. That is because common ownership and control is a necessary corollary to treating separately incorporated entities as if they were fully owned divisions of a single corporation. The combined report methodology was upheld by this Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). Under this methodology, all income and factors of a commonly controlled and sufficiently integrated multicorporate group are combined in a single report in order to arrive at the income attributable to the activities conducted in the taxing state.

The second area of controversy involving the application of the unitary business principle is not concerned with determining which divisions and/or controlled entities are part of the unitary business. Rather, it arises after the scope of the unitary business group has been determined and involves a separate question. That question is whether particular items of income, such as dividends, interest, rents, royalties and capital gains, are subject to apportionment because they arise from property interrelated with or constituting an integral part of the conduct

of the taxpayer's unitary business, or whether they are subject to specific allocation on a situs or other basis because they arise from property dissociated from the unitary business. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont, supra,* 445 U.S. 425 was the first decision of this Court to address the question of apportionment versus specific allocation of income from intangibles in the context of state income taxes. *Mobil* established that more-than 50 percent ownership and control is not a necessary prerequisite for dividend apportionability. *Mobil* involved both subsidiary "(more than 50% owned)" (Id. at 428, n.1) and non-subsidiary (affiliated) corporations of which "it owned, directly or indirectly, 5% or more of the capital stock." Ibid. In fact, a major portion of the dividends at issue in *Mobil* came from Aramco "of which appellant (Mobil) owned 10% of the capital stock." Id. at 430, n.5. In upholding the apportionment of dividends from affiliates, which formed part of a functionally integrated enterprise with the payee, where the ownership interest was *significantly* less than 50%, this Court clearly proceeded on the assumption that majority ownership and control are not constitutionally required.[3]

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[3] It is important to note that in *Mobil* this Court did not reach the issue whether foreign source dividends are properly subject to tax by *any* state. See *Mobil, supra,* 445 U.S. 425, 446 ("[A]ppellant eschews the broad proposition that foreign source dividends are immune from state taxation"). See also *Container, supra,* 463 U.S. 159, 169, n.7. Chevron does not concede the propriety of any such state taxation. Under the Foreign Commerce Clause there are significant issues whether this can give rise to unconstitutional multiple taxation of the dividend income. The discussion herein assumes, for purposes of argument, that there is no constitutional prohibition to the taxation of the dividend income.

This Court's decisions in *ASARCO* and *Woolworth* should not be read otherwise. However, those decisions contain language which, if read out of context, could be argued to support the view that the criterion of "management control" used for determining whether a subsidiary should be included in a combined report group, should also be used as the basis for permitting apportionment of intangible income.[4] See *ASARCO*, 458 U.S. at 321-322, 323-324. In the final analysis, however, the opinions are unclear as to the type of "unitary business *relationship*" (*ASARCO, supra*, 458 U.S. 307, 325) or "functional integration" (*Woolworth, supra*, 458 U.S. 354, 364) between the activities of the dividend payor and those of the payee, that may be constitutionally required.[5] In fact, its

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[4] Notably, both *ASARCO* and *Woolworth* involved foreign subsidiaries where combined reports could have been required and where sizable amounts of stock related income was included with no reflection of the underlying apportionment factors of the subsidiary giving rise to the intangible income. Whether the cases would have been decided differently if the state apportionment formulas there involved had given some recognition to the underlying factors of the dividend paying subsidiaries and affiliates is difficult to determine.

[5] It is noteworthy that in *ASARCO*, this Court did not reject out of hand the notion that dividends from ASARCO's minority interests in General Cable, Revere Copper and Mexicana were subject to apportionment. Similarly, ASARCO's lack of voting control in 51% owned Southern Peru Copper was only one of the factors leading to this Court's conclusion that ASARCO and Southern Peru Copper were not integrated or interdependent. While there were significant intercompany sales by Southern Peru Copper to ASARCO for the years in question, "[t]here was evidence that ASARCO could replace this output contract '[w]ithin a short time' if it were lost, and that loss of ASARCO's ownership in Southern Peru would not cause the loss of the output contract" (*ASARCO, supra*, 458 U.S. 307, 321, n.17).

decisions appeared to be based on a detailed review of the record and uncontroverted findings of fact by the trial court.[6] *ASARCO* and *Woolworth* can be reconciled with *Mobil* and *Butler Bros.* on the ground that majority ownership and control may be important in some instances to assist in establishing integration at the managerial level when other equally important factors relevant to establishing functional integration between the dividend payor and payee are not present.

The rule of law which should be clearly reaffirmed in the present case, is that there is *no* requirement that dividends be received from a "unitary subsidiary" in the sense of combined reporting control and ownership requirements in order to classify dividends as apportionable business income. Rather, it is sufficient that the dividend paying subsidiaries and affiliates contribute in some meaningful way to the payee's unitary business and thus function as part of the payee's unitary business. For purposes of determining apportionable business income the Constitution requires nothing more.[7]

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[6] For example, this Court noted in *ASARCO* that the dissent's characterization of the companies involved as "captive suppliers and customers" was "at odds with the undisputed facts" (Id. at 325, n.21).

[7] However, there remains the issue whether adjustments to the apportionment formula are required. See Argument V, infra.

III. APPORTIONABLE BUSINESS INCOME MAY ALSO EXIST IN CERTAIN CIRCUMSTANCES WHERE THERE IS NO UNITARY RELATIONSHIP IN ANY SENSE BETWEEN THE UNDERLYING BUSINESSES OF THE PAYOR AND PAYEE OF DIVIDENDS.

It is agreed by the parties and various amici that there are a number of situations where income from intangibles is apportionable even though there is an absence of a unitary relationship, in any sense, between the businesses of the payor and payee. The example used by all is income from short term investments for the purpose of providing working capital. Another example is the temporary investment in stock of entities listed on national stock exchanges of funds set aside for such things as workers' compensation claims, rain and storm damage and machinery replacement.

The necessary connection of a particular item of income with the unitary business of the taxpayer can be established in other ways as well. Even longer term investments in functionally unrelated businesses may bear an integral relationship to the business of the taxpayer conducted within the taxing jurisdiction. As the dissenting opinion in *ASARCO* correctly recognized, "the interim investment of retained earnings prior to their commitment to a major corporate project . . . merely recapitulates on a grander scale the short-term investment of working capital prior to its commitment to the daily financial needs of the company." *ASARCO, supra,* 458 U.S. 307, 338 (O'Connor, J., dissenting). In determining whether income is part of the unitary business of the taxpayer or is nonbusiness income, it is essential to define

the transactions and activities which are the elements of the taxpayer's trade or business. This is the approach taken under UDITPA.

Under UDITPA, all income is classified as either business or nonbusiness. UDITPA "distinguishes between the 'business income' of a multi-jurisdictional enterprise which is apportioned by formula and its 'nonbusiness income' which is not." *Container Corporation of America v. Franchise Tax Board, supra,* 463 U.S. 159, 167. UDITPA defines "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." UDITPA § 1(a). "Nonbusiness income" is defined as "all income other than business income." UDITPA § 1(e).[8]

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[8] The Multistate Tax Commission's regulations which interpret UDITPA set forth a "presumption" in favor of business income and provide that "the income of a taxpayer is business income unless clearly classifiable as nonbusiness income." MTC Reg. § IV.1.(a). The regulations make the characterization of income as apportionable business income as opposed to allocable nonbusiness income turn largely on the "business purpose" for which the intangibles are acquired or held. See MTC Reg. §§ IV.1.(c)(3)-(5). This analysis is closely tied to the due process requirement of showing sufficient contribution to the business conducted in the taxing state. This is not an unworkable subjective standard. As used in the regulations "business purpose" is simply a shorthand reference to the existence of underlying objective facts demonstrating a close or integral relationship between the business of the taxpayer and the income producing property.

The UDITPA approach to the definition of business income is reasonable and quite workable. If the relationship between the underlying businesses of the payor and payee is *not* a unitary one, the inquiry should not end there. The question remains whether the property giving rise to the income is held as an integral part of the taxpayer's unitary business. If so, any income generated in the form of dividends (or capital gains upon sale) should be treated as apportionable business income. If not, the income should be considered nonbusiness. Indeed, while this Court in *ASARCO* took exception to the "corporate purpose" standard utilized in UDITPA as applied in that case by Idaho to ASARCO's long term investments, it is evident that this Court did not question the appropriateness of dividend apportionment in all circumstances in which a unitary relationship between the underlying businesses of the dividend payor and payee was absent. See *ASARCO, supra,* 458 U.S. 307, 325, n.21. See also id., at 337-8 (O'Connor, J., dissenting). This Court should clearly set forth its approval of dividend apportionment in those cases where stock is held for a purpose directly related to the operations of the taxpayer's unitary business enterprise.[9]

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[9] It should be made clear that adoption of the UDITPA approach does not necessarily mean that all income will be considered business income subject to apportionment. Even under the Multistate Tax Commission's regulations, which contain a presumption in favor of business income, there are examples of transactions and activities which generate nonbusiness income. See MTC Reg. §§ IV.1.(c) (1) Examples (iv), (v), (vii); (2) Example (v); (3) Example (vi); (4) Example (vi); (5) Example (iii).

The UDITPA rules for determining whether income is business or nonbusiness (and the Multistate Tax Commission regulations interpreting UDITPA) are a reasonable attempt at a difficult task. Their adoption by a majority of the states is a good indication of their viability. An opinion by this Court which indicates the general acceptability of UDITPA's approach would go a long way to promoting uniformity and the avoidance of multiple taxation in this area – a development which is sorely needed.

IV. A PRESUMPTION IN FAVOR OF APPORTIONMENT AVOIDS THE APPLICATION OF ARBITRARY SITUS RULES AND PROMOTES UNIFORMITY.

Absent the adoption of uniform apportionment and allocation rules, there exists a potential for duplicative taxation of a multistate corporate taxpayer, particularly on income from such items as capital gains, dividends, interest and royalties, where, regardless of the relationship of the income to the taxpayer's multistate business operations, the state of legal domicile or commercial domicile or some other state asserts full taxing jurisdiction on the basis of a fictional "situs" of the corporation.[10] Similarly, there exits a potential for avoidance of taxation where such business-related income items are not taxed

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[10] See Dexter, Taxation of Income from Intangibles of Multistate-Multinational Corporations, 29 Vanderbilt L.Rev. (1976) 401, 402-403, stating that a legal basis for taxing the same intangible income may exist in five different jurisdictions giving rise theoretically to quintuple taxation if each state were to press its jurisdictional claims to the fullest extent.

because a state is persuaded that legitimate tax jurisdiction lies elsewhere. The application of UDITPA's uniform apportionment and allocation rules to all items of income, regardless of labels, avoids the problem of duplicative taxation and at the same time assures that foreign corporations engaged in unitary business operations within a UDITPA state pay their fair share of tax on capital gains and losses, dividends, interest, royalties and the like which arise out of or are related to such operations.

UDITPA's presumption in favor of business income avoids the application of an arbitrary commercial domicile rule in situations where either the taxpayer or taxing authority is unable to demonstrate by clear and cogent evidence that the income was unrelated to the unitary business enterprise. It is noteworthy that this Court has expressed strong reservations concerning the view that dividend income should be specifically allocated to the state of commercial domicile of the payee. See *Mobil, supra,* 445 U.S. 425, 444-446. Even in *ASARCO* and *Woolworth,* there was no indication that this Court concluded the dividend income involved was wholly taxable by the respective commercial domicile states.

There is "nothing talismanic" about the concept of commercial domicile in the area of corporate taxation of income from intangibles. *Mobil, supra,* 445 U.S. 425, 445. As a matter of due process, the state in which a multistate or multinational corporation maintains its commercial domicile has no greater claim for taxing dividends than any other state in which the payee is present. See ASARCO, *supra,* 458 U.S. 307, 346-7 (O'Connor, J., dissenting).

It is difficult to see why taxation of the entire intangible income of a corporation by the state of corporate domicile, regardless of any relationship of such income to the business activities of the corporation conducted within that state, can be said to be more rational from a due process standpoint than the full apportionment of such otherwise unattributable intangible income to all of the states in which the corporation conducts its business.[11]

The "commercial domicile" rule for assigning a taxable situs to intangibles rests on the ancient doctrine of *mobilia sequuntur personam*, which is a legal fiction bearing no relationship to either the economic realities underlying the generation of the income of a multistate or multinational business enterprise, nor the underlying due process requirement of rationality. See *Mobil*, 445 U.S. 425, 445-446 (" '[T]he reason for a single place of taxation no longer obtains' when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction"). Because the fiction unjustifiably favors the domiciliary state at the expense of other states in which the corporation conducts its business, the Court would be fully justified in concluding that

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[11] As the dissenting Justices correctly pointed out in *ASARCO*:

> "Surely it is highly anomalous that the Due Process Clause should require the dividend income of a far-flung interstate business selectively to be attributed solely to the State or two in which a few minimal securities management functions are carried out, rather than apportioned among all the States whose 'civilized society' has made the income-generating wealth of the larger enterprise possible." (*ASARCO, supra*, 458 U.S. 307, 348.)

nothing in the Due Process Clause prevents full apportionment of all intangible income, absent a clear showing that the income producing property was held in the course of activities having nothing to do with the conduct of a taxpayer's multistate unitary business operations. Such a conclusion would be consistent with the presumption expressed in the regulations of the Multistate Tax Commission that all income is apportionable business income unless "clearly classifiable" otherwise.[12]

V. WHERE DIVIDENDS ARE FOUND TO BE APPORTIONABLE BUSINESS INCOME DUE TO THE UNITARY RELATIONSHIP BETWEEN THE PAYOR AND PAYEE, THE PAYEE'S APPORTIONMENT FORMULA SHOULD BE ADJUSTED TO TAKE THE PAYOR'S FACTORS INTO ACCOUNT.

While the issue of apportionment formula adjustments apparently is not being pursued by Petitioner herein and was not reached by this Court in *Mobil*,[13] *ASARCO* or *Woolworth*, it should be a necessary element in this Court's consideration of the constitutional principles applicable to state taxation of intangible income of multistate and multinational corporations. It is an issue in states which require combined reports and in those which do not. It has spawned considerable litigation in the state courts and will continue to do so.[14] Where stock giving

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[12] See footnote 8, *supra*, at p. 14.

[13] This issue was considered by Justice Stevens in his dissent.

[14] See for example *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me., 1991); *American Telephone & Telegraph Co. v. Wisconsin Department of Revenue*, 422 N.W.3d 629 (Wisc., 1988); *NCR Corporation v. South Carolina Tax Commission*, 402 S.E.2d 666 (S.C., 1991).

rise to apportionable dividends or gains is held for a purpose directly related to the taxpayer's unitary business operations, but there is no operational integration between the dividend payor and dividend payee, no formula adjustment may be required.[15] However, in the case of functionally integrated subsidiaries and affiliates, the adjustment of the payee's apportionment formula to take into account the factors of a dividend payor is necessary to assure that the unitary enterprise is treated in a consistent manner.

In such a situation, "the dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise." *Mobil, supra,* 445 U.S. 425, 440. There is no change in the underlying economic realities of the unitary business, whether the income is generated by a division or is repatriated as dividends from a separate legal entity. Accordingly, in either case, the tax treatment should be the same. In the former situation, the division's property, payroll and sales factors utilized in generating the income are includable in the apportionment formula in order to determine the proper amount of income attributable to the taxpayer's activities in the taxing state. The same analysis should also obtain in the latter situation. Otherwise, as Justice Stevens stated in *Mobil*:

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[15] This of course would not preclude a taxpayer from demonstrating in the appropriate case that some type of formula adjustment is necessary in order to assure that the income apportioned to the taxing state is rationally related to values connected with the taxing state. See UDITPA § 18; MTC Reg. § IV. 18.

> "Unless the sales, payroll and property values connected with the production of income by the payor corporations are added to denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base *will inevitably cause Mobil's Vermont income to be overstated.*" Id. at 461. (Emphasis added.)

Under this Court's external consistency standard, factors used in the apportionment formula must actually reflect a reasonable sense of how the taxpayer's income is generated.[16] There is a symmetrical relationship between the income base and the factors. If the symmetry is absent in a particular case, unconstitutional extraterritorial taxation can occur. For example, where foreign source income is included in the apportionable income base, but none of the foreign factors which generated that income are included in the apportionment formula, the formula will inevitably attribute too much income to the taxing state and too little to the foreign jurisdictions. See *American Telephone & Telegraph Co. v. Wisconsin Department of Revenue, supra,* 422 N.W.2d 629, 636; *Bass, Ratcliff & Gretton v. State Tax Commission,* 266 U.S. 271 (1924). See also Rudolph, State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups, 25 Tax L. Rev. 171, 205 (1970).[17]

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[16] *Container Corporation of America v. Franchise Tax Board, supra,* 463 U.S. 159, 169.

[17] As indicated by Justice Stevens and Justice O'Connor in their respective dissents in *Mobil* and *ASARCO*, such a violation of the Due Process Clause could also be a violation of the Commerce Clause:

(Continued on following page)

The inclusion of large sums of intangible income, such as dividends, in the apportionable income base, without any inclusion in the apportionment formula of the factors of the payor which generated the earnings from which the dividends were paid, raises serious questions whether the apportionment formula is fair. Where the dividend income is includable due to the functional integration existing between the payor and payee, consistent application of the unitary business principle requires that the formula be adjusted to take into account this unitary relationship.

CONCLUSION

ASARCO and *Woolworth* do not need to be overruled. Rather, the decisions can be reconciled with *Mobil*, *Butler Bros.* and *Container* if one concludes that majority ownership and control are not necessary criteria for apportioning dividends. This Court should clarify that *ASARCO* and *Woolworth* set forth a non-exclusive manner in which

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"[I]f in a particular case, use of an allocation formula has the effect of taxing income earned by an interstate entity outside the State, it could alternatively be said to have the effect of taxing the income earned by that entity inside the State at a rate higher than that used for a comparable, wholly intrastate business, a discrimination that violates the Commerce Clause." *Mobil, supra*, 445 U.S. 425, 452, n.4 (Stevens, J., dissenting); *ASARCO, supra*, 458 U.S. 307, 350, n.14 (O'Connor, J., dissenting).

to establish the apportionability of income and that functional integration between affiliated corporations has never been the sole basis on which intangible income could be apportioned. Apportionment is also proper where the stockholdings from which the income is derived are demonstrated to be an integral part of the business operations of the taxpayer conducted in the taxing state. This Court should validate the general approach to apportionment taken under UDITPA, but avoid the application of arbitrary situs rules. Finally, this Court should consider the significant issues raised concerning the fairness of the apportionment formula where substantial sums of intangible income are includable in a state's apportionable income base.

Dated: April 9, 1992

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Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

ALLIED-SIGNAL INC.
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

SUPPLEMENTAL BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

	Page
INTRODUCTORY STATEMENT	1
INTEREST OF *AMICUS CURIAE*	2
SUMMARY OF ARGUMENT	3
ARGUMENT	5
I. UNDER THE DOCTRINE OF STARE DECISIS, *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED	5
II. *ASARCO* AND *WOOLWORTH* CANNOT BE OVERRULED WITHOUT DESTROYING LONG-STANDING CONSTITUTIONAL PRINCIPLES	6
CONCLUSION	14

TABLE OF AUTHORITIES

CASES — Page

Adams Express Company v. Ohio State Auditor, 165 U.S. 194 (1896) 7, 9
Arizona v. Rumsey, 467 U.S. 203 (1984) 3, 5
ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982) ..... *passim*
Bass, Ratcliff & Gretton, Limited v. State Tax Commission, 266 U.S. 271 (1924) 7, 8
Butler Brothers v. McColgan, 315 U.S. 501 (1942) 9
Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983) 4, 6, 9, 10, 12
Exxon Corporation v. Department of Revenue of Wisconsin, 447 U.S. 207 (1980) 7, 10
Miller Bros. v. Maryland, 347 U.S. 340 (1954) 6
Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980) 7, 8, 9, 10
Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) 7
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) 6
Patterson v. McLean Credit Union, 491 U.S. 164 (1989) 3, 5, 6
Payne v. Tennessee, 111 S.Ct. 2597 (1991) 3, 5
Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891) 7
Smith v. Allwright, 321 U.S. 649 (1944) 3, 5
State R.R. Tax Cases, 92 U.S. 575 (1875) 3, 7
Swift & Co. v. Wickham, 382 U.S. 111 (1965) 3, 5
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920) 6, 8
Wallace v. Hines, 253 U.S. 66 (1920) 8
Welch v. Texas Department of Highways and Public Transportation, 483 U.S. 468 (1987) 3
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940) 6
F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico, 458 U.S. 354 (1982) ..... *passim*

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SUPPLEMENTAL BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter and will address the first question presented in this Court's order of March 11, 1992, that is, whether this Court should overrule *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F.W. Woolworth Co. v. Taxation & Rev-*

enue Department of the State of New Mexico, 458 U.S. 354 (1982). Written consents of the petitioner and respondent have been obtained and filed with the Clerk of Court.

INTEREST OF *AMICUS CURIAE*

At issue in this case is the continued viability of the unitary concept and the protections given by the Due Process and Commerce Clause to multistate corporate taxpayers from the overreaching by jurisdictions in which they conduct business. Therefore, the Committee on State Taxation, an organization with a membership of 364 major multistate corporations, has a great interest in the issues currently being considered by this Court.

The Committee on State Taxation ("COST") is a nonprofit association originally organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. Its purpose is to promote the adoption of state tax systems which will enhance the ability of business to effectively compete in the marketplace free from inequitable, discriminatory and unconstitutional practices which may place corporate taxpayers at a competitive disadvantage. COST's member companies conduct a substantial portion of the interstate commerce of United States taxpayers and are representative of that part of the nation's business sector which is directly affected by state taxation of interstate operations.

COST's objectives include the promotion of proper methods of assigning values, income and taxable incidents among the various states. In working towards this objective, COST and its member companies have relied on the unitary principles as set forth by this Court in a long line of decisions and reinforced in *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982). If these decisions are overruled, the due process and com-

merce clause restraints which are the basis for the unitary principle will be destroyed. Therefore, COST clearly has a vital interest in this case.

SUMMARY OF ARGUMENT

This Court has stated that the "doctrine of stare decisis is of fundamental importance to the rule of law." *Welch v. Texas Dept. of Highways and Public Transportation*, 483 U.S. 468, 494 (1987). Therefore, "overruling a precedent of this Court is a matter of no small import" *Payne v. Tennessee*, 111 S.Ct. 2597, 2617 (1991) (Souter, concurring), and "[a]ny departure from the doctrine of stare decisis demands special justification", *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984), particularly where an established constitutional principle is concerned. *Smith v. Allwright*, 321 U.S. 649, 666 (1944).

In those anomalous situations in which this Court has deviated from the doctrine of stare decisis, special justification for the propriety of such action has been established. Special justification has been evidenced where there has been an intervening development in the law, *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989); where there is a need for coherence or consistency, *Patterson*, *supra* at 173; where the old rule is unworkable, *Swift & Co. v. Wickham*, 382 U.S. 111, 116 (1965), or where the constitutional rule had absolutely no basis in constitutional text, historical practice, or in logic. *Payne*, *supra*, at 2613 (Scalia, concurring). None of these criteria is present in the instant case.

This Court's decisions in *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982) are the outgrowth of a long line of due process and commerce clause jurisprudence dating from the late 1800's, *see*, *State R.R. Tax Cases*, 92 U.S. 575 (1875), and most recently repeated in *Container Corporation of America v. Franchise*

Tax Board, 463 U.S. 159 (1983). These cases present a correct and coherent interpretation and application of the limitations placed on the state's taxing power by the Due Process and Commerce Clauses. These clauses of the Constitution "do not allow a State to tax income arising out of interstate activities—even on a proportional basis—unless there is a minimal connection or nexus between the interstate activities and the taxing State . . . [cites omitted]." *Container, supra*, at 165.

This long line of cases has been relied upon by both the states and taxpayers, and while the two groups may disagree on the application of the unitary principles to a particular fact situation, all are in full understanding of the basic legal concepts as they have been established by this Court in the last one hundred years.

The only "special justification" offered by the State of New Jersey for departing from the doctrine of stare decisis and the overruling of these long standing principles is that the result is "grossly unfair" because it prevents the State from "getting a fair crack at large amounts of investment income". Tr. of Oral Argument at 40. Certainly, one hundred years of case law should not be precipitously overruled because it would allow one state, in one case, to impose a larger tax.

ASARCO and *Woolworth* were not decided in a vacuum and cannot be overruled in a vacuum. They cannot be overruled without also overruling this Court's decisions which led up to and followed them. They cannot be overruled without rendering the unitary concept meaningless. They cannot be overruled without injurious and unexpected results. Therefore, COST strongly urges this Court to reaffirm its decisions in *ASARCO* and *Woolworth* and, for the reasons set forth in its original brief, asks this Court to reverse the decision of the New Jersey Supreme Court.

ARGUMENT

I. UNDER THE DOCTRINE OF STARE DECISIS, *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED

As this Court recognized in *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989) "[t]his Court has said often and with great emphasis that 'the doctrine of stare decisis is of fundamental importance to the rule of law.' *Welch v. Texas Department of Highways and Public Transportation*, 483 U.S. 468, 494 (1987)." "Stare decisis is the preferred course because it promotes the even-handed, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Payne v. Tennessee*, 111 S.Ct. 2597, 2609 (1991). Thus, "overruling a precedent of this Court is a matter of no small import", *Payne*, *supra* at 2617 (Souter, concurring), and "the necessity and propriety of doing so" must be established. *Patterson*, *supra* at 172. "Any departure from the doctrine of stare decisis demands special justification", *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984), particularly where an established constitutional principle is concerned. *Smith v. Allwright*, 321 U.S. 649, 666 (1944).

In determining whether "special justification" for overruling a particular case exists, this Court has relied on several factors. Thus, this Court has overruled precedent where there has been an intervening development in the law, *Patterson*, *supra* at 172, or where the constitutional rule set forth in the case has "absolutely no basis in constitutional text, in historical practice, or in logic." *Payne*, *supra* at 2613 (Scalia, concurring). Additionally, this Court has departed from precedent it found erroneous where that precedent is unworkable. *Swift & Co. v. Wickham*, 382 U.S. 111, 116 (1965), or where the prior case causes confusion and is a detriment to coherence and consistency, *Patterson*, *supra* at 173, and "[f]inally,

it has sometimes been said that a precedent becomes more vulnerable as it becomes outdated. . . ." *Patterson, supra* at 174. As will be discussed below, none of these factors is present in this case. Therefore, there is no justification for departing from stare decisis and the holdings in *ASARSO* and *Woolworth* should be acknowledged as governing the state taxation of intangible investment income earned by multistate corporations.

II. *ASARCO* AND *WOOLWORTH* CANNOT BE OVERRULED WITHOUT DESTROYING LONG-STANDING CONSTITUTIONAL PRINCIPLES

It has long been recognized that a state tax will not withstand Due Process and Commerce Clause scrutiny unless there is a sufficient nexus between the taxing state and the activities sought to be taxed. *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 452 (1959). *See also, Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940). There must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-345 (1954). It is this due process and commerce clause requirement of nexus that is at the heart of the instant case.

Separate geographical accounting comports with this constitutional requirement, but separate accounting has generally been rejected by the states on the ground that it "often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 164-165 (1983). Therefore, the unitary concept was developed as a means of determining the instate value of a multistate entity that is inherently indivisible. Recognizing the "impossibility of allocating specifically the profits earned by the processes conducted within [a state's] borders", *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), this Court has held that

a state is "justified in attributing . . . a just proportion of the profits earned by the Company from [a] unitary business." *Bass, Ratcliff & Gretton, Limited v. State Tax Commission*, 266 U.S. 271, 282 (1924). The decisions of this Court make clear that it is the existence of a unitary entity that creates a sufficient link with the state for due process and commerce clause purposes. *See, Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 439 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 223 (1980). It is only after this unitary entity is established that formulary apportionment is appropriate to determine "a rough approximation of the income properly attributable to the taxing state." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 271 (1978).

The "unit" rule was first developed and applied one hundred years ago in the area of property taxation and used to value property located in more than one jurisdiction. *See, e.g., State R.R. Cases*, 92 U.S. 575 (1875); *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18 (1891). As this Court explained in discussing *Pullman's Palace* in *Adams Express Company v. Ohio State Auditor*, 165 U.S. 194, 221 (1896), "the taxation of the corporation in Pennsylvania was sustained on the theory that the whole property of the company might be regarded as a unit plant, with a urit value, a proportionate part of which value might be reached by the state authorities on the basis indicated." The Court noted that the purpose of the "unit rule" is not to "attempt to tax property having a situs outside of the State, but only to place a just value on that within." *Adams Express Company, supra* at 227. Thus,

> [t]he only reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess . . . Therefore no property of such an interstate road

> situated elsewhere can be taken into account unless it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the State.

Wallace v. Hines, 253 U.S. 66, 69 (1920).

This unit rule was later extended to state income taxation. In *Underwood Typewriter, supra* at 120-121, this Court held that the use of an apportionment formula which included all of a company's income in the tax base met the constitutional nexus requirement because

> [t]he profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. . . [The legislature] adopted a method of apportionment which, for all that appears in the record, reached, and was meant to reach, only the profits earned within the State.

Similarly, this Court held that "the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business" in *Bass, Ratcliff & Gretton, Limited v. State Tax Commission*, 266 U.S. 271, 282 (1924). In *Bass*, this Court found that "the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales." *Id.*

This Court has applied the unitary concept throughout this century in a long line of cases. *Container, supra* at 163-165 and cases cited therein. The basic principle underlying all of these cases is that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 439 (1980).

In applying the unitary business principle to state income taxation, the Court has always recognized, as it

emphasized in *Adams*, that unity requires "a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business." 165 U.S. at 222. This Court has always required that there be unity of ownership, use and management, that is, a functional integration of the businesses sought to be included in the unitary business. *Butler Brothers v. McColgan*, 315 U.S. 501, 508 (1942). Most recently, in *Container*, *supra*, the Court stated that the

> prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value* . . . As we reiterated in *F.W. Woolworth*, a relevant question in the unitary business inquiry is whether " 'contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale.' " 458 U.S. at 364, 102 S.Ct., at 3135, quoting *Mobil*, 445 U.S., at 438, 100 S.Ct., at 1232.

463 U.S. at 178-179 (emphasis and brackets in original).

Thus, in *Mobil* this Court found that the dividend income arose from a unitary business because the taxpayer "made no effort to demonstrate that the foreign operations of its subsidiaries and affiliates are distinct in any business or economic sense from its petroleum sales activities in Vermont" so that the State "was entitled to conclude that the dividend income's foreign source did not destroy the requisite nexus with in-state activities." 445 U.S. 441, 439-440. Nevertheless, this Court, prior to its decisions in *ASARCO* and *Woolworth*, recognized in *Mobil* that

> [w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business.

Mobil, *supra* at 442.

Mobil makes clear that income which is earned in the course of activities that are unrelated to the operating business activities within a state may not be taxed by the state because there is no unitary business. *Mobil, supra* at 439. If the income is derived from an " 'unrelated business activity' which constitutes a 'discrete business enterprise,' ", *Exxon, supra* at 224, quoting *Mobil*, it is not part of a unitary business having nexus with a state and cannot be subject to apportionment. Rather, intangible income must be "derived from a functionally integrated enterprise", *Mobil, supra* at 440, before a state may constitutionally impose its tax on that income.

Moreover, after its decisions in *Mobil, ASARCO* and *Woolworth*, this Court, consistent with those cases, stated that in order to have constitutional nexus,

> the out-of-state activities of the purported "unitary business" be related *in some concrete way* to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement-*beyond the mere flow of funds arising out of a passive investment or a distinct business operation*—which renders formula apportionment a reasonable method of taxation.

Container, supra at 166 (emphasis added). This Court further recognized in *Container* that it was "made clear in *F.W. Woolworth Co.* that a unitary finding could not be based merely on 'the type of occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment . . .' 458 U.S., at 369." 463 U.S. at 180, fn. 19.

Thus, *ASARCO* and *Woolworth* did not enunciate some principle pulled from thin air for use only in those cases. Rather, those cases involved the application of constitutional nexus requirements that have been developed by

this Court in over one-hundred years of case law. *ASARCO* and *Woolworth* are part of a whole cloth woven by the long line of cases enunciating the unitary principles. *ASARCO* and *Woolworth* cannot be overruled without causing this cloth to unravel. As noted in *ASARCO*, the general principle that a State may not tax value earned outside its borders dates to the early years of state income taxation and the application of this general principle in this case is guided by this Court's decisions in *Mobil* and *Exxon*. *ASARCO*, *supra* at 315. That *ASARCO* and *Woolworth* are integral threads in the unitary cloth is further evidenced by this Court's reliance on those cases in *Container*, its most recent decision applying the unitary principles.

Clearly, the constitutional principles enunciated in *ASARCO* and *Woolworth* have long been found to be constitutionally mandated, as well as having a basis in logic and historical practice. The unitary concept has not become outdated over time or through intervening developments in the law, but has continued to be strengthened in a logical and coherent fashion. *ASARCO* and *Woolworth* cannot be overruled without doing serious damage, if not destroying, the entire unitary principle developed by this Court over the last one hundred years. They cannot be overruled without also overruling *Mobil*, or, at the very least, calling into question every other unitary decision of this Court and destroying the constitutional underpinnings of multistate taxation. Such action would have unforeseen and unexpected implications for both states and taxpayers. There is no justification for this Court taking such a dangerous and precipitous course.

While the "legal principles defining the constitutional limits on the unitary business principle are now well estabilshed" it is not disputed that in determining whether related corporate subsidiaries are unitary can be difficult and time consuming in that "the factual records in [unitary] cases . . . are long and complex . . .". *Container*,

supra at 176. Whether functional integration exists between related corporations is a fact sensitive issue. While both taxpayers and states may prefer a brightline test[1] for administrative ease, this easy course is not available, as the decisions of this Court have consistently held that "apportionment, which takes into account the entire business income of a multistate business in determining the income taxable by a particular state, is *constitutionally permissible only in the case of a unitary business.*" *ASARCO*, *supra* at 329, fn.14 (emphasis added). One hundred years of constitutional jurisprudence cannot be renounced on the basis that the constitution is not administratively convenient.

New Jersey's alternative, that the unitary concept be abandoned, Tr. of Oral Argument at 35-40, cannot stand because it does not comport with the nexus requirements of the Due Process and Commerce Clauses, however administratively convenient such an option may be. However, with regard to the taxation of intangible income received from investments in unrelated corporations, *Mobil*, *ASARCO* and *Woolworth* do provide a brightline test, that even the State of New Jersey admits is "workable". Tr. of Oral Argument at 40.

Nevertheless, the State of New Jersey wishes to discard this workable, brightline rule in favor of a chaotic world with no rules at all. The State acknowledged that its proposal of including all income received in apportionable income will result in problems that "should be dealt with through the apportionment formula." Tr. of Oral Argument at 48. The State has rejected factor representation as a solution, and failed to offer any means to prevent the taxation of income earned outside the State. Tr. of Oral Argument at 48. Additionally, the potential for unconstitutional multiple taxation is readily apparent, as a state would be free to require domiciliary corpora-

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[1] Or, in New Jersey's case, that "no inquiry . . . be made at all." Tr. of Oral Argument at 32.

tions to allocate one-hundred percent of its investment income to it, while other states would require, in addition, that part of the income be apportioned to them. Clearly, the adoption of New Jersey's approach would simply lead to years of litigation by taxpayers over the proper means of adjusting the apportionment formula to prevent unconstitutional taxation. This is not a consistent, workable test or justification for the overruling of *ASARCO* and *Woolworth*. The State has not proven that the doctrine of stare decisis should not be adhered to in the instant case.

New Jersey would have the settled rules of multistate taxation abandoned in favor of a world with no rules and no standards. New Jersey is asking that one-hundred years of Supreme Court case law be abandoned simply so that it can get a "crack at large amounts of investment income", Tr. of Oral Argument at 40, which are clearly unrelated to a taxpayer's business activities within the State and increase its tax coffers at the expense of nondomiciliary corporations.

New Jersey has failed to offer any justification, much less a *special* justification for the overruling of *ASARCO* and *Woolworth*. It offers no constitutional or logical basis for the abandonment of the unitary principle, only that to do so would allow it to collect tax dollars from passive investment income having no connection with a corporation's business activities within its borders. Therefore, under the principles of stare decisis, this Court should refuse to overrule its decisions in these cases.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in its original brief, the Committee on State Taxation respectfully requests that the decisions in *ASARCO* and *Woolworth* be affirmed and the decision of the New Jersey Supreme Court be reversed.

Respectfully submitted,

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Dated: April 10, 1992

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Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

In The
Supreme Court of the United States
October Term, 1991

Allied-Signal, Inc., as successor-in-interest
to The Bendix Corporation,
Petitioner

v.

Director, Division of Taxation,
Respondent

On Writ of Certiorari to the Supreme Court
Of the State of New Jersey

SUPPLEMENTAL BRIEF OF AMICI CURIAE IN SUPPORT OF DIRECTOR, DIVISION OF TAXATION OF THE STATE OF NEW JERSEY BY THE STATE OF CALIFORNIA AND THE STATES OF ALASKA, IDAHO, KANSAS, MAINE, NEW HAMPSHIRE AND VERMONT

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QUESTIONS PRESENTED

1. Should the Court overrule *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co.* v. *Taxation and Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES v

INTEREST OF AMICI CURIAE 1

STATEMENT PURSUANT TO RULE 37 3

SUMMARY OF ARGUMENT 3

ARGUMENT

I THE DECISIONS OF THIS COURT IN *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED 6

A. INTRODUCTION 6

B. APPORTIONABILITY OF DIVIDEND INCOME, OR ANY INCOME FROM AN INTANGIBLE, SHOULD NOT BE DETERMINED SOLELY BY REFERENCE TO THE RELATIONSHIP BETWEEN THE ACTIVITIES OF THE ISSUER AND THE ACTIVITIES OF THE HOLDER 8

C. CORPORATE PURPOSE IS THE CORRECT STANDARD FOR DETERMINING THE APPORTIONABILITY OF INCOME . . . 10

D. SUBSEQUENT DECISIONS OF THE COURT HAVE OVERRULED OR SEVERELY LIMITED TWO MAJOR POINTS OF THE MAJORITY'S ANALYSIS IN *ASARCO* AND *WOOLWORTH* 11

1. Introduction 11

2. Potentials 12

3. Relationship of Out-of-State Activities to In-State Activities 13

II THE OVERRULING OF *ASARCO* AND *WOOLWORTH* SHOULD BE RETROACTIVE IN EFFECT 16

III THE UNITARY BUSINESS PRINCIPLE AS INTERPRETED IN THIS COURT'S DECISIONS, OTHER THAN *ASARCO* AND *WOOLWORTH*, SHOULD ESTABLISH THE LIMITS ON STATE TAXATION OF CORPORATIONS DOING BUSINESS IN SEVERAL STATES 17

A. INTRODUCTION 17

B. THE UNITARY BUSINESS PRINCIPLE IS AN APPROPRIATE STANDARD FOR DETERMINING THE APPORTIONABILITY OF INCOME 19

C. THE NEW JERSEY ASSESSMENTS CAN BE SUSTAINED UNDER A BURDEN-OF-PROOF ANALYSIS WITHOUT REQUIRING AN ABANDONMENT OF THE UNITARY BUSINESS PRINCIPLE 24

D. EVEN IF THE COURT HOLDS THAT APPLICATION OF THE UNITARY BUSINESS PRINCIPLE IS UNNECESSARY IN THE CIRCUMSTANCES OF A SINGLE ENTITY, THE UNITARY BUSINESS PRINCIPLE SHOULD BE PRESERVED FOR COMBINED REPORT PURPOSES 26

CONCLUSION 29

TABLE OF AUTHORITIES

Page(s)

CASES:

Amerada Hess Corp. v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989) 6, 14, 21

American Smelting & Refining Co. v. *Idaho State Tax Com.*, 102 Idaho 38, 624 P.2d 946 (1981) 6

ASARCO Inc. v. *Idaho State Tax Commission*, 458 U.S. 307 (1982) . . . . . *passim*

Bass, Ratcliff & Gretton, Ltd. v. *State Tax Commission*, 266 U.S. 271 (1924) 20

Butler Brothers v. *McColgan*, 315 U.S. 501 (1942) 20

Complete Auto Transit, Inc. v. *Brady*, 430 U.S. 274 (1977) 22, 29

Container Corporation of America v. *Franchise Tax Board*, 463 U.S. 159 (1983) . . . . . *passim*

Edison California Stores v. *McColgan*, 30 Cal.3d 472, 183 P.2d 16 (1947) 26

Exxon Corporation v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980) 22, 29

F.W. Woolworth Co. v. *Taxation and Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982) . . . . . *passim*

Hans Rees' Sons, Inc. v. *North Carolina ex rel Maxwell*, 283 U.S. 123 (1931) 19, 23, 25

International Harvester Co. v. *Evatt*, 329 U.S. 416 (1947) 23

Mobil Oil Corp. v. *Commissioner of Taxes*, 445 U.S. 425 (1980) . . . . . *passim*

Moorman Mfg. Co. v. *Bair*, 437 U.S. 267 (1978) 23

Norton Co. v. *Department of Revenue*, 340 U.S. 534 (1951) 12

Shell Oil Company v. *Iowa Department of Revenue*, 488 U.S. 19 (1988) 6, 14, 21

Underwood Typewriter Co. v. *Chamberlain*, 254 U.S. 113 (1920) 17, 19, 20

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INTEREST OF AMICI CURIAE

Amici are states which compute the individual tax liabilities of multijurisdictional taxpayers under the "unitary

business principle."[1] Among amici, the "unitary business principle" is applied in virtually all of its variants including the "single entity" and "combined report" forms. Amici share with New Jersey a common concern as to the limits upon state income taxation which arise from the Due Process Clause and Commerce Clause of the Constitution. In particular, amici are concerned with the Due Process Clause and Commerce Clause standards for determining when income arising from the ownership of intangible property can be subjected to apportionment.

Amici have a direct interest in the clarification of the questions raised by the Court in its order for reargument in this case. The resolution of these questions affects billions of dollars in state taxes annually. Amici have a particular interest in the clarification of the proper application of this Court's decisions in *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F.W. Woolworth Co.* v. *Taxation and Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982), and more specifically in whether or not it is necessary to establish that there is a "unitary business" relationship between the holder and the issuer of an intangible in order to subject income from that intangible to apportionment. Amici believe the Court should overrule both of these cases.

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[1] The unitary method includes both formulary apportionment and combined reporting. Every jurisdiction uses some type of formulary method to assign income, and roughly half of the states use a variant of the combined report method.

STATEMENT PURSUANT TO RULE 37

This brief is submitted pursuant to Rule 37.3 of this Court in support of Respondent, the Director, Division of Taxation, State of New Jersey. Consent to the filing of this brief has not been requested from the parties because the amici filing this brief are the Attorneys General of their respective states and because of the invitation of this Court contained in its order of March 11, 1992. Rule 37.5 U.S. Sup. Ct.

SUMMARY OF ARGUMENT

The Court should overrule its decisions in *ASARCO* and *Woolworth* for all the reasons set forth by the dissent in those cases and for other reasons as well. Those cases, argued and decided in tandem, are aberrations. They are inconsistent with the large body of decisions issued by this Court which have given rise to the unitary business principle. This body of decisional law which constitutes the unitary business principle both predates and postdates *ASARCO* and *Woolworth*.

The question addressed in *ASARCO* and *Woolworth* was a narrow one: Under what conditions could a nondomiciliary state include dividends in the apportionable income base of the shareholder. Those cases addressed this question in a framework which was analytically and/or factually flawed. New Jersey and amici California, et al., are asking this Court to address the issue, which it treated Idaho as conceding in *ASARCO*, of whether it is necessary for the activities of the issuer of an intangible and the activities of the holder of an intangible to be unitary for income arising from

the intangible to be apportionable as to its holder. Amici submit that such a relationship is not required. Amici further submit that this is a "scope of the unitary business" question and that the correct inquiry involves determining whether the income arises in connection with the conduct of the unitary business of the taxpayer.

Apportionability should be established by and through the activities of the holder of the intangible. If the activities of the issuer and the activities of the holder are "unitary," then the income is invariably apportionable. It is apportionable, however, not because the issuer and holder are "unitary," but because the income arises from the activities of the holder which are part of the unitary business. The correctness of this result can be illustrated by considering the type of income involved in the present case: capital gains. The issuer of the underlying security has no income from the trading of its securities and therefore no tax. It is only the holder which has income and therefore tax, and it is only the holder's activities which can determine apportionability.

The overruling of *ASARCO* and *Woolworth* would eliminate the major source of confusion in this Court's "unitary business principle" jurisprudence. This Court does not need to fashion new constitutional standards for the evaluation of state taxes, however. Removal of the confusion created by *ASARCO* and *Woolworth*, will reestablish a sound and workable framework for evaluating the New Jersey assessments.

The Due Process Clause and Commerce Clause provide limitations on the power of states to tax, not requirements as to how they must tax. New Jersey, in its argument to this Court on March 4, 1992, correctly pointed out that application of the analytical framework of the "unitary

business principle" to state tax cases can give rise to the need for an extended factual inquiry (Oral Argument, pp. 32-34). A simpler standard would obviate the need for this inquiry which this Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), characterized as "long and complex and [where] the line between 'historical fact' and 'constitutional fact' is often fuzzy at best. Cf. *ASARCO*, 458 U.S. at 326-328, nn. 22, 23." 463 U.S. at 176. Because this Court is speaking to limitations and not requirements, it may wish to accept New Jersey's suggestion of the simpler rule of full apportionability in the single entity context.

Amici, however, ask this Court to keep in mind in considering this question that the case before it involves a "single entity" state, not a "combined report" state. In the "single entity" circumstance, there is no question that the first element of the Due Process Clause requirement—"minimal connection"—is satisfied. In the "combined report" circumstance, however, a state, while not taxing entities which are not present within its boundaries, is nonetheless considering their income and apportionment factors. Under existing unitary business principles, there is no unanswered question as to whether application of the combined report method is constitutionally permitted except for the reservation expressed in *Container* with respect to its application to foreign country-based businesses. 463 U.S. at 189 n. 26 and 195 n. 32. If the unitary business principle is abandoned or altered significantly, these questions may arise again. With these reservations and considerations in mind, amici endorse New Jersey's effort to obtain relaxed constitutional limits upon state taxing authority.

ARGUMENT

I

THE DECISIONS OF THIS COURT IN *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED

A. INTRODUCTION

In *ASARCO* and *Woolworth*, the Court applied settled principles of constitutional Due Process Clause and Commerce Clause analyses to decide a narrow issue, the apportionability of dividends. These cases were before the Court on factual, *Woolworth*,[2] and analytical, *ASARCO*,[3] predicates which were flawed. The dissent in both *ASARCO*, 458 U.S. at 331-353, and *Woolworth*, 458 U.S. at 373-374, recognized these flaws and correctly concluded that the cases should have been decided differently. In addition, subsequent decisions of the Court (*Container*, *Shell Oil* and *Amerada Hess*. See discussions and citations *infra* at pp. 11-15) have rejected

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[2] In *Woolworth*, the Court noted that the New Mexico Supreme Court had "observed that, 'regrettably, it needs to be said that the State did a very poor job of inquiring into and developing the facts in this case.'" 458 U.S. at 360.

[3] In *ASARCO*, the Court stated "Neither does it [Idaho] question that a unitary business relationship between ASARCO and these subsidiaries [the dividend payors] is a necessary prerequisite to its taxation of the dividends at issue." 458 U.S. at 325. It should also be noted that in the Idaho Supreme Court, the primary issue was the combined reporting treatment applied to the unitary subsidiaries. The treatment of the dividends was only an ancillary issue. *American Smelting & Refining Co.* v. *Idaho State Tax Com.*, 102 Idaho 38, 624 P.2d 946 (1981).

elements of the *ASARCO* and *Woolworth* majority's analysis in two areas—the significance of the potential for control and the need for a direct connection between in-state and out-of-state activities—providing further support for overruling these decisions. Overruling the holding of these decisions on the narrow issue presented would not require this Court to overrule or abandon the settled principles of constitutional analysis set forth in the preamble of *ASARCO*, 458 U.S. at 315-320.

Prior to engaging in an analysis of why *ASARCO* and *Woolworth* should be overruled, amici believe it is important for the Court to recognize the different components of the unitary business principle analysis as set forth in their original brief filed in this matter (Brief of Amici California, et al., pp. 6-9). These components are: (1) the scope of the unitary business, (2) the income arising from the unitary business, and (3) the apportionment formula. Each of these components can require a different analysis although there can also be common threads to the analysis of each. Confusion as to whether *ASARCO* and *Woolworth* involved the **scope** or **income** component colored the Court's analysis and led to an erroneous result. As indicated in Amici California, et al.'s previous brief, this confusion led to the application of the analytical framework of the **scope** component to what should have been analyzed pursuant to the analytical framework of the **income** component.

B. APPORTIONABILITY OF DIVIDEND INCOME, OR ANY INCOME FROM AN INTANGIBLE, SHOULD NOT BE DETERMINED SOLELY BY REFERENCE TO THE RELATIONSHIP BETWEEN THE ACTIVITIES OF THE ISSUER AND THE ACTIVITIES OF THE HOLDER

The principal question involved in *ASARCO* and *Woolworth* was whether, in order to sustain the inclusion of dividends in apportionable income, it is necessary for the activities of a payor to be unitary with the activities of the payee. In *ASARCO*, this question was viewed as having been conceded by the State, and the majority opinion's analysis reflects this concession. With this concession, the outcome was a foregone conclusion. New Jersey and amici do not concede this question. Proper analysis establishes the error of the concession and the need to overrule both of these cases.

The relevant inquiry in determining whether an item of income arising from an intangible[4] is apportionable is the relationship of the holding of the intangible to the business of the holder. Only the holder of the intangible has income; therefore, only the holder should be taxed. There is no necessary relevance of the activities of the issuer of the intangible in determining the apportionability of the income in the hands of the holder. For further discussion, see Brief of Amici California, et al., pages 10-21.

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[4] The logic of this analysis is not restricted just to income arising from the holding of an intangible, it applies to all items of income. For purposes of this discussion, however, the focus is solely upon intangibles.

This does not mean that the relationship of the intangible, or item of income, to the activities of the holder can never be established by examining the relationship between the activities of the holder and the activities of the issuer. If there is a unitary relationship between the activities of the issuer of an intangible and the holder of the intangible, then the apportionability of the income is invariably established.[5]

It does mean, however, that an operational relationship between the activities of the holder of an intangible and the activities of the issuer of the intangible is not the exclusive means of determining apportionability. The activities of the issuer and holder need not be unitary for the income arising from an intangible to be apportionable. Examples of such circumstances are provided in the brief previously filed by Amici California, et al., on pages 16-17.

An examination of the treatment of capital gains, the issue directly involved herein, illustrates the fallacy of the requirement of an issuer/holder unitary relationship. This is not to say that dividends and capital gains require a different analysis or that a different result is required depending on the type of receipt. To the contrary, the fact that the analytical framework used for the dividends in *ASARCO* is inapplicable to capital gains proves that it was faulty. In the case of capital gains arising from the ownership of stock, the issuer of the stock has no earnings when the stock is bought and sold

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[5] If the activities of the payor and the activities of the recipient are part of the same unitary business, a scope-of-the-business analysis, then either the dividends would be apportionable income in the hands of the recipient or, if the combined report methodology was employed by the state, all of the income of the payor and its apportionment factors would be considered by the taxing state, and the dividends would be eliminated or disregarded.

by the third parties. The gains realized, or losses sustained, may reflect the outside world's view of the results of the issuer's activities, or they may have no relationship whatsoever; e.g., merger mania may have been partially involved in creating the gain in this case. The point is, the third-party seller is the only entity which has income, in both a taxable and economic sense, and therefore is the only entity which can be assessed a tax on those results. Thus, the apportionability of income is properly decided solely by reference to the taxpayer/recipient's activities.

C. CORPORATE PURPOSE IS THE CORRECT STANDARD FOR DETERMINING THE APPORTIONABILITY OF INCOME

A state, in assessing a tax on or measured by income, looks to the income of the taxpayer. With respect to a taxpayer which is not domiciled or organized within its boundaries, the state may tax only that income which is determined to be related to activities within its boundaries. This amount has normally been determined through apportionment.[6] In determining whether an item of income can be considered, the state must look to some factor or factors. The only factors which are relevant are those relating

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[6] In some cases, this is determined by rules of allocation. This can occur when under the Uniform Division of Income for Tax Purposes Act the income is nonbusiness income, that is, it does not arise from the unitary business.

to the taxpayer, for it is its tax which is being determined and its income which is being considered.

This Court in *ASARCO* rejected too hastily "corporate purpose" as the test. 458 U.S. at 326-329. "Corporate purpose," correctly defined, is the proper standard for determining apportionability. "Corporate purpose" has meaning when it is understood as being controlled by the purpose for which the corporation holds the asset.[7] For example, if the taxpayer holds itself out as actively engaged in acquiring, managing and disposing of intangibles as part of its operational business strategy and in furtherance of its operating business, then a state can, consistent with the requirements of Due Process analysis, conclude that it is generating "business income" from such activities.

D. SUBSEQUENT DECISIONS OF THE COURT HAVE OVERRULED OR SEVERELY LIMITED TWO MAJOR POINTS OF THE MAJORITY'S ANALYSIS IN *ASARCO* AND *WOOLWORTH*

1. Introduction

As a preliminary matter, it should be noted that both of the points which have been limited, and which are discussed hereinafter, relate to a scope-of-the-unitary-business inquiry, not to the apportionability of income, and therefore

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[7] Perhaps the term "unitary purpose" or "business purpose" more accurately captures the distinction between apportionable and allocable income.

are not necessarily relevant to the determination of the question here at issue. (See Brief of Amici California, et al., pp. 6-9.) These points were discussed in *ASARCO* and *Woolworth* because the decisions analyzed the question presented as a scope-of-the-business approach, or as if the question presented was whether the payors of the dividends could have been included in a combined report. As discussed previously, pages 8-10, the inability to include a dividend payor in a combined report should not be a bar to treating the dividend as apportionable income. The Court's subsequent limitations on its analyses in *ASARCO* and *Woolworth* show the tenuous nature of these holdings.

2. Potentials

In *Woolworth*, this Court held that the New Mexico courts erred in making their unitary determinations "largely by emphasizing the potentials of the relationship. . . ." 458 U.S. at 363.[8] In effect, the Court was addressing a question involving the burden of proof and placing it upon the State. In so holding, the Court disregarded its prior holdings "that a taxpayer claiming immunity from a tax has the burden of establishing his exemption," *Norton Co.* v. *Department of Revenue*, 340 U.S. 534 (1951), and that in a unitary business principle analysis, the taxpayer must show that the activities sought to be excluded are part of a "discrete business

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[8] The potential unitary relationship was also involved in *ASARCO* but to a lesser extent. In that case, it was noted that there was sufficient ownership to control operations with respect to Southern Peru Copper, 458 U.S. at 320, and M.I.M. Holdings, 458 U.S. at 323, but that control was not exercised. In the case of other two-dividend payors, ASARCO owned less than 50 percent of the common stock.

enterprise," *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 at 439 (1980).

In *Container*, the Court reaffirmed the burden of proof principles called into question by *ASARCO* and *Woolworth*. 463 U.S. at 175-176. In addition, the Court held that the state court in *Container* had done more than rely upon "mere *potential* to control," 463 U.S. at 177 (Court's emphasis), relying instead upon the stipulated fact "that '[h]igh officials of appellant gave directions to subsidiaries for compliance with the parent's standard of professionalism, profitability, and ethical practices.' [citations.]" This should not, however, be read as an endorsement of the proposition that "potential" is an insufficient standard. The Court's contrary intent is revealed in a footnote to its discussion where it went on to say: "In any event, although potential control is, as we said in F.W. Woolworth, not '*dispositive*' of the unitary business issue, id., at 362 [citations] (emphasis added), it is *relevant*, both to whether or not the components of the purported unitary business share that degree of common ownership which is a prerequisite to a finding of unitariness, and also to whether there might exist a degree of implicit control sufficient to render the parent and the subsidiary an integrated enterprise." 463 U.S. at 177 n. 16 (Court's emphasis).

3. Relationship of Out-of-State Activities to In-State Activities

In *ASARCO*, the Court suggested that in order for a state to consider an activity which occurred outside of its boundaries, it was necessary that it show that such activity was related directly to activities within its boundaries when it

stated that "ASARCO's Idaho silver mining and Southern Peru's autonomous business are insufficiently connected to permit the two companies to be classified as a unitary business." 458 U.S. at 322. The Court has specifically discussed this question in two subsequent cases and rejected it.

In *Shell Oil Company* v. *Iowa Department of Revenue*, 488 U.S. 19 (1988), the Court considered whether income earned from the sale of oil and gas extracted from the Outer Continental Shelf (OCS) could be considered by Iowa, a state with no ocean boundaries, in its apportionable base. In answering this question in the affirmative, the Court stated:

> "Shell's argument hinges on the mistaken premise that including OCS-derived income in the preapportionment tax base is tantamount to the direct taxation of OCS production. But income that is included in the preapportionment tax base is not, by virtue of that inclusion, taxed by the State. Only the fraction of total income that the apportionment formula determines (by multiplying the income tax base by the apportionment fraction) to be attributable to Iowa's taxing jurisdiction is taxed by Iowa." 488 U.S. at 30.

In *Amerada Hess Corp.* v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989), the Court considered whether New Jersey could disallow deductions of the federal Windfall Profits Tax when there was no oil production within the state. The Court rejected the taxpayer's argument that a state could not disallow an exclusively out-of-state expense stating:

> "Appellants, however, underestimate the fact that, for apportionment purposes, it is inappropriate to consider the windfall profit tax as an out-of-state expense. Rather, just as each appellant's oil-producing revenue—as part of a unitary business—is not confined to a single State, [citations omitted] so too the costs of producing this revenue are unitary in nature. [Citations omitted] (the costs of a unitary business cannot be deemed confined to the locality in which they are incurred). Thus, when a State denies a deduction for a cost of a unitary business, the resulting net figure is still a unitary one, which a State may legitimately decide to apportion according to the standard three-factor apportionment formula. [Footnote omitted]." 490 U.S. at 74.

If the rule suggested in *ASARCO* is followed, then any particular unitary business will change its configuration from state to state depending upon the direct ties which exist to the activities in each separate state. This result simply makes no sense and is contrary to the Court's upholding in *Container* that "a State not tax a purported 'unitary business' unless at least some part of it is conducted in the State." 463 U.S. at 166. This requirement does not necessitate that activities in the taxing state have direct and separate ties to each out-of-state activity.

II

THE OVERRULING OF *ASARCO* AND *WOOLWORTH* SHOULD BE RETROACTIVE IN EFFECT

ASARCO and *Woolworth* closely followed in time *Mobil*, and immediately preceded *Container*. *ASARCO* and *Woolworth*, however, are aberrations and cannot truly be reconciled with either *Mobil* or *Container*, or any of the other cases in this area, except by distinguishing on the basis of inadequately developed factual records (*Woolworth*, and to a lesser degree, *ASARCO*) or analytical concessions viewed as having been made by the losing party (*ASARCO*). *ASARCO* and *Woolworth* should be discarded as precedential authority.

Because of the unique circumstances of *ASARCO* and *Woolworth*, their overruling was clearly foreshadowed, even at the time they were rendered,[9] and was effectively accomplished by *Container*. Amici endorse the position set forth by Amici Virginia, et al., to be filed concurrently herein as to the appropriate standard for resolving retroactivity. The standards for retroactive application of the overruling of *ASARCO* and *Woolworth* are met.[10]

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[9] *Mobil*, 445 U.S. 425.

[10] An argument can be made that the question in this case is not whether a decision in favor of New Jersey and overruling *ASARCO* and *Woolworth* should be retroactive, but whether those cases should be applied retroactively to limit the assessment of the tax proposed herein. The transaction which gave rise to the tax here at issue occurred in 1981, prior to the Court's decision in *ASARCO* and *Woolworth*.

III

THE UNITARY BUSINESS PRINCIPLE AS INTERPRETED IN THIS COURT'S DECISIONS, OTHER THAN *ASARCO* AND *WOOLWORTH*, SHOULD ESTABLISH THE LIMITS ON STATE TAXATION OF CORPORATIONS DOING BUSINESS IN SEVERAL STATES

A. INTRODUCTION

In considering this question, it is important to keep in mind the difficulties inherent in determining the appropriate amount of income to assign to a state. These difficulties were recognized in the first unitary income tax case, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920), where the Court at 120-121 stated:

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut, and ending with sale in other states. In this it was typical of a large part of the manufacturing business conducted in the state. The legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders."

These difficulties were also commented upon in *Container*, where this Court compared the allocation of income among various taxing jurisdictions to the task of "slicing a shadow." 463 U.S. at 192. In comparing formulary apportionment with arm's-length/separate accounting, the only alternative suggested, this Court in *Container* stated:

> "One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise. See generally Mobil Oil Corp., supra, at 438-439, [citations omitted] and sources cited. The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's

> activities within and without the jurisdiction. This Court long ago upheld the constitutionality of the unitary business/formula apportionment method, although subject to certain constraints. See, e.g., Hans Rees' Sons, Inc. v. North Carolina ex rel Maxwell, 283 U.S. 123 (1931) [citations omitted]; Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, supra; Underwood Typewriter Co. v. Chamberlain, supra. The method has now gained wide acceptance, and is in one of its forms the basis for the the [sic] Uniform Division of Income for Tax Purposes Act (Uniform Act), which has at last count been substantially adopted by 23 States, including California." 463 U.S. at 164-165.

This comparison leads inescapably to the conclusion that in determining the amount of income which a state can consider, states should continue to have the option of choosing a formulary apportionment mechanism of some kind.

B. THE UNITARY BUSINESS PRINCIPLE IS AN APPROPRIATE STANDARD FOR DETERMINING THE APPORTIONABILITY OF INCOME

The unitary business principle has been a fixture in state taxation for over one hundred years. It was first applied in the area of property taxation. Shortly after the advent of state corporate income taxes, the unitary business principle was sanctioned for use by this Court as a means of dividing the income tax base among various jurisdictions. *Underwood*,

254 U.S. 113. It has a long history of acceptance and is employed in some form by every single subnational jurisdiction in this country which asserts an income tax.

This Court's decisions, with the exception of *ASARCO* and *Woolworth*, to which your first inquiry was directed, have been evolutionary in nature. Each subsequent decision has built upon the framework established in prior cases, adapting to changes in the manner in which businesses operate.

The major cases in this evolutionary series include:

> *Underwood Typewriter*, 254 U.S. 113 (1920), which addressed the circumstance of a single corporation's activities involving the manufacture of a product in one state with sales in several states.
>
> *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924), which involved a single corporation manufacturing a product in another country and selling in several states.
>
> *Butler Brothers* v. *McColgan*, 315 U.S. 501 (1942), which involved a single corporation with a central buying office in one state and distribution centers in a number of states.
>
> *Mobil Oil Corp.* v. *Vermont*, 445 U.S. 425 (1980), which was the first case to deal with the multiple entity pattern, "foreign source" income and, specifically, the taxation of income

> arising from intangibles held as an asset of the operating business.
>
> *Container Corporation of America* v. *Franchise Tax Board*, 463 U.S. 159 (1983), which squarely addressed the questions presented by the multicorporate business with international operations.
>
> *Shell Oil Company* v. *Iowa Department of Revenue*, 488 U.S. 19 (1988) and *Amerada Hess Corp.* v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989), which established the principle that there is no requirement that an item of income arise or an expense be incurred directly in a state for it to be considered as part of unitary income.

The most significant of these cases is *Container*. It summarizes prior precedent and deals with *ASARCO* and *Woolworth*. It is a "capstone" opinion. The Court should re-endorse the principles reiterated therein.

These principles, taken from *Container* and other cases, include the following:

> Due Process Clause and Commerce Clause analyses establish principles of limitation upon state taxation but do not establish requirements for state taxation. "[T]here are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach."

Container, 463 U.S. at 167. "[T]he Constitution imposes no single formula on the States. *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 445 (1940)." *Container*, 463 U.S. at 164.

"[T]here is a 'minimal connection' or 'nexus' between the interstate activities and the taxing State and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.' *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, [447 U.S. 207 at 219-220 (1980)]." *Container*, 463 U.S. at 165-166.

A tax, to be constitutional, must be applied to an activity with a substantial nexus with the taxing state, be fairly apportioned, not discriminate, and be fairly related to the services provided by the state. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 at 279 (1977).

Due Process Clause and Commerce Clause nexus is established by the fact that some part of the unitary business is conducted in the taxing state. *Container*, 463 U.S. at 166.

The unitary business principle and formula apportionment is a "proper and fair method of taxation." *Container*, 463 U.S. at 184.

> The taxpayer has the burden to prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State' [*Hans Rees' Sons, Inc.* v. *North Carolina ex rel Maxwell*, 283 U.S. 123 at 135 (1931)] or has 'led to a grossly distorted result,' [*Norfolk & Western R. Co.* v. *Missouri State Tax Comm'n*, 390 U.S. 317 at 326 (1968)]." *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267 at 274 (1978).
>
> The taxpayer must show that the activities to be excluded are part of a "discrete business enterprise." *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 at 439 (1980).
>
> "In the case of a more-or-less integrated business enterprise operating in more than one State . . . arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and practice." *Container*, 463 U.S. at 164. Rough approximation is all that is required. *International Harvester Co.* v. *Evatt*, 329 U.S. 416 (1947).

None of these principles is compromised to the slightest extent by an overruling of *ASARCO* and *Woolworth*; therefore, there is no reason to abandon them even if *ASARCO* and *Woolworth* are overruled. To do so would be tantamount to throwing the baby out with the bathwater.

C. THE NEW JERSEY ASSESSMENTS CAN BE SUSTAINED UNDER A BURDEN-OF-PROOF ANALYSIS WITHOUT REQUIRING AN ABANDONMENT OF THE UNITARY BUSINESS PRINCIPLE

In applying these principles to the case before this Court, it should be recognized that New Jersey is a "single entity" state. It does not use the "combined report" approach. In a "single entity" state, the state looks only to the results of each single corporate entity which is present within its boundaries in determining the income base subject to formulary apportionment. In a "combined report" state, the state will look beyond individual corporate boundaries in determining the amount of income which is to be included in the income base subject to apportionment. (See argument D, *infra*, for the analysis in a combined report environment.)

The difference in corporate form chosen by a business may lead to a different tax result in a "single entity" state such as New Jersey than it would in a "combined report" state. These practical consequences are permissible, *Container*, 463 U.S. at 167-169, and have significance in the context of the burden of proof.

A taxpayer can control its tax exposure in New Jersey by the simple expediency of establishing wholly owned subsidiaries. If Bendix had chosen to hold its interest in ASARCO in a separately incorporated subsidiary which had no direct contact with New Jersey, New Jersey would not now be laying claim to an apportioned share of the gain. If New Jersey were a combined report state, it would. When this practical difference is combined with the principle that a taxpayer has the burden of showing that the state tax

assessment is out of all appropriate proportion to the activities done with the state, *Hans Rees' Sons, Inc.* v. *North Carolina ex rel Maxwell*, 283 U.S. 123, 135 (1931), and the duty to show that the activities to be excluded arise from a "discrete business enterprise," *Mobil*, 445 U.S. 425, different results may arise in the "single entity" as compared to the "combined report" setting because of burdens of proof. These differences are not necessarily of a constitutional dimension but are real nonetheless.

If Bendix wished to establish that its ownership of shares of ASARCO was a "discrete business enterprise," the New Jersey law provided it with a failsafe method—separate incorporation. Bendix did not use the method provided by New Jersey. New Jersey and its courts drew a logical conclusion from that failure—the ownership of the ASARCO shares was not part of a "discrete business enterprise." Bendix had the opportunity to refute this conclusion and did not do so. Therefore, the New Jersey assessments should be sustained.

Sustaining the New Jersey assessments in this case does not require the Court to abandon the unitary business principle and adopt a mandatory rule of full apportionment within a single corporate entity. The Court need merely recognize that the Due Process Clause does not prohibit the New Jersey approach. Other approaches which do not extend so far, e.g., business/nonbusiness and separate line of business statutory distinctions, would remain permitted. Amici concur with New Jersey's representative (Transcript of Oral Argument, March 4, 1992, pp. 32-34) that unnecessary application of the unitary business principle in the circumstances of this case may give rise to extensive discovery

and protracted disputes over which activities are part of the unitary business.[11]

D. EVEN IF THE COURT HOLDS THAT APPLICATION OF THE UNITARY BUSINESS PRINCIPLE IS UNNECESSARY IN THE CIRCUMSTANCES OF A SINGLE ENTITY, THE UNITARY BUSINESS PRINCIPLE SHOULD BE PRESERVED FOR COMBINED REPORT PURPOSES

The purpose of the "combined report" approach is to prevent a business from manipulating its state tax results by the use of separate corporate forms. The California Supreme Court explained it as follows in *Edison California Stores* v. *McColgan*, 30 Cal.2d 472 at 479-480, 183 P.2d 16 (1947):

> "In the present case all of the elements of a unitary business are present—unity of ownership, unity of operation by centralized purchasing, management, advertising and accounting, and unity of use in the centralized executive force and general system of operation. The business of the parent and all

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[11] A simple ownership rule might well alleviate this particular factual inquiry undertaken under both the Due Process Clause and Commerce Clause but could give rise to an alternative Commerce Clause inquiry—whether the apportionment formula fairly reflects the activities which gave rise to the income, or what this Court in *Container* termed the "external consistency" test, 463 U.S. at 169—but based upon the same essential facts. It is not, however, present in this case and therefore there is no need for the Court to consider it in deciding the issue before it.

> of its subsidiaries is owned and managed under one centralized system, to the same extent as in the Butler Brothers case and other cases considered therein. Thus the business is unitary regardless of the fact that in the Butler Brothers case there was but one corporation involved, owning as parts of the unitary system seven different branches in as many states, and that in the present case there is a parent corporation owning and controlling as units of one system fifteen different branches organized as corporations in as many states. No difference in principle is discernible. If the crux of the matter is to ascertain that portion of the business which is done within this state, then the same considerations justify the use of the formula allocation method in the one case as in the other."

In *Container*, 463 U.S. at 168, in discussing the unitary business concept as applied to a multi-corporate unitary business, the Court, quoting *Mobil*, stated:

> "'Superficially, intercorporate division might appear to be a[n] . . . attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise.' *Id.*, at 440."

The use of a combined report is a scope-of-the-business question in its clearest form. The income and factors of a separate corporation are includable only if they are within the unitary business carried on by the corporate entity present in the taxing state. The tests for inclusion invariably include a requirement of controlling ownership, as was illustrated by the treatment proposed by the State of Idaho with respect to ASARCO and its various related entities, 458 U.S. at 312-314. The combined report question presents a different question than whether dividends are apportionable. (See pp. 8-10, *infra*.) In *Mobil*, the Court permitted Vermont to include dividends received, principally from Aramco in which Mobil held only a ten-percent interest,[12] in apportionable income. No one suggested that Mobil's Aramco interest should give rise to a combined report including all of Mobil's and Aramco's income and activities.

In the circumstance of a single entity, the requisite jurisdictional nexus for Due Process purposes is supplied by its presence. Clearly, the single entity is present in the state or no tax would be assessed. In the combined report context, however, a state, though not taxing entities which are not present within its boundaries, nonetheless considers their income and activities and the question of jurisdictional nexus becomes more significant. If the parent corporation is present in the taxing state, the ownership ties with its subsidiaries may be sufficient to also allow for jurisdictional nexus to be established. If it is, however, only a subsidiary which is present within the state, the "upstream" jurisdictional nexus may be more problematical. In these circumstances, this

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[12] 445 U.S. at 430 n. 5.

Court has relied upon the unitary business principle to establish the required jurisdictional nexus. *Container*, 463 U.S. at 165-166. Loss of this jurisdictional nexus could provide a blueprint for wholesale state tax manipulation by corporate taxpayers. The very problems which were originally addressed by California when adopting the combined report procedure could be reinstated with a constitutional imprimatur of legitimacy. A taxpayer, relying solely on its ability to control its corporate structure and domicile, could manipulate its state tax payments. Form would triumph over substance. Amici respectfully submit that this is not a result which this Court should countenance.

CONCLUSION

The decision of the New Jersey Supreme Court should be sustained and the decisions of this Court in *ASARCO* and *Woolworth* should be overturned.

The Court should reaffirm its commitment to the constitutional standards set forth in *Complete Auto Transit*, 430 U.S. 274 (1977)[13] and *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980)[14], and to the unitary business principle. It should affirm that these are principles of limitation on state action and not requirements for state action. In the circumstances of this case, where the apportionability of the income of a single entity is at issue, a relaxation of the unitary business principle would not run afoul of the Constitutuion. If such a relaxation is adopted, it should be limited to the circumstances of this case so as not

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[13] Nexus, fair apportionment, nondiscriminatory, and fairly related.

[14] Minimal connection and rational relationship.

to eviscerate the combined report method. A taxpayer should not be allowed to manipulate its state tax results through the use of the corporate form.

Dated: April 8, 1992

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Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,
v.
DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the
Supreme Court of New Jersey

BRIEF AMICUS CURIAE OF MULTISTATE TAX COMMISSION IN SUPPORT OF RESPONDENT ON REARGUMENT

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QUESTIONS PRESENTED ON REARGUMENT

1. Should the Court overrule *Asarco* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co.* v. *Taxation & Revenue Department*, 458 U.S. 354 (1982)?

2. If *Asarco* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *Asarco* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in the several states?

TABLE OF CONTENTS

Page(s)

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES v

INTEREST OF THE AMICUS CURIAE 1

SUMMARY OF ARGUMENT 2

ARGUMENT 3

I. *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED, BECAUSE THEY CONTAIN AT LEAST THREE ERRONEOUS CONCEPTS, WERE POSSIBLY UNFAIRLY INFLUENCED BY AN UNFOUNDED SUSPICION AND AN INADEQUATE RECORD, AND FAILED TO IDENTIFY A WORKABLE STATE TAX SYSTEM WITH RESPECT TO THE APPORTIONMENT OF INTANGIBLE INCOME. 3

A. *The Court Erroneously (i) Used Language Suggesting An Exclusive Test For Determining The Apportionability Of Intangible Income; (ii) Endorsed Too Narrow A View Of A Unitary Business; and (iii) Disregarded The Probative Value Of Establishing "The Potentials Of The Relationship" Among Affiliated Business Segments.* 4

B. *The Results In* ASARCO *And* Woolworth *May Have Been Unfairly Influenced By An Unfounded Suspicion Of The States' Motives And By An Inadequate Record.* 13

C. *The Court Should Identify The State Tax System Or Systems It Seeks To Uphold Regarding The Apportionability Of Intangible Income.* 16

II. *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED RETROACTIVELY, BECAUSE UNDER *CHEVRON OIL CO.* v. *HUSON*, 404 U.S. 97 (1971), SUCH A HOLDING WOULD NOT ESTABLISH A NEW PRINCIPLE OF LAW AND *ASARCO* AND *WOOLWORTH* DID NOT ESTABLISH ANY DEFENSIBLE CONSTITUTIONAL PRINCIPLE UPON WHICH TAXPAYERS COULD HAVE EQUITABLY RELIED. 17

III. THE CONSTITUTION PERMITS STATES TO APPORTION INCOME IN ACCORDANCE WITH THE FORMAL IDENTITY OF SEPARATELY ORGANIZED BUSINESS ENTITIES AS WELL AS TO EMPLOY OTHER THEMES OF A UNITARY BUSINESS INVOLVING THE USE OF COMBINED REPORTING AND/OR DISTINCT BUSINESS REPORTING. 18

A. *The Constitution Permits States To Fashion Logically Consistent Approaches To Dividing The Income Of A Multistate Business That Do Not Produce Arbitrary And Unfair Results.* 18

B. *New Jersey's System Of Taxation That Fully Apportions The Income Of Separately Organized Business Entities With Sufficient Nexus In The Taxing State Provides Fundamental Fairness.* 21

C. *The Constitution Additionally Permits Other States To Employ The Unitary Business Principle That Is More Expansive Than What Is Suggested In ASARCO and Woolworth To Support Combined Reporting And/Or Distinct Business Reporting.* 23

D. *Any System of State Taxation Allied-Signal Would Propose For Taxing Intangible Income Is Not Constitutionally Required.* 26

CONCLUSION 30

TABLE OF AUTHORITIES

Page(s)

CASES:

Adams Express Co. v. *Ohio*, 165 U.S. 194 (1897) 7,21

Amerada Hess Corp. v. *New Jersey Dept. of Treasury*, 490 U.S. 66 (1989) 6

American Home Products Corp. v. *Director, Div. of Taxation*, 11 N.J. Tax 287 (Tax Ct. 1990), *app. pending*, N.J. Super. Ct., No. A-4316-90T3 25

American Smelting & Refining Co. v. *Idaho State Tax Comm'n*, 99 Idaho 924, 592 P.2d 32 (1979) 14

ASARCO Inc. v. *Idaho State Tax Comm'n*, 458 U.S. 307, *reh. denied*, 459 U.S. 961 (1982) . . . . . *passim*

Butler Bros. v. *McColgan*, 315 U.S. 501 (1942) 7,8,24

Chevron Oil Co. v. *Huson*, 404 U.S. 97 (1971) 17

Complete Auto Transit, Inc. v. *Brady*, 430 U.S. 274 (1977) 19

Container Corp. of America v. *Franchise Tax Bd.*, 463 U.S. 159, *reh. denied*, 464 U.S. 909 (1963) . . . . . *passim*

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F.W. Woolworth Co. v. *Taxation & Revenue Dept. of New Mexico*, 458 U.S. 354 (1982), *reh. denied*, 459 U.S. 961 (1982) . . . . . *passim*

Internat'l Shoe Co. v. *Washington*, 326 U.S. 310 (1945) 19

James v. *Internat'l Telephone & Telegraph Corp.*, 654 S.W.2d 865 (Mo. Banc 1983) 5

McKesson Corp. v. *Div. of Alcoholic Beverages & Tobacco*, 110 S.Ct. 2238 (1990) 17-18

Miller Bros. Co. v. *Maryland*, 347 U.S. 340 (1954) 19

Mobil Oil Corp. v. *Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980) . . . . . *passim*

Moorman Mfg. Co. v. *Bair*, 437 U.S. 267 (1978) 20

Nat'l Geographic Society v. *California Bd. of Equalization*, 430 U.S. 551 (1977) 19

Northwestern States Portland Cement Co. v. *Minnesota*, 358 U.S. 450 (1959) 29

Norton Co. v. *Dept. of Revenue*, 340 U.S. 534 (1951) 20

U.S. Steel Corp. v. *Multistate Tax Commission*, 434 U.S. 452 (1978) 20

U.S. CONSTITUTION:

U.S. Const., art. I, §8, cl. 3 (Commerce Clause) 18,20

U.S. Const., amend XIV, §1 (Due Process Clause) 18,20

STATUTES:

26 U.S.C. §531 (1988) 25

26 U.S.C.A. §6038A (West Supp. 1992) 16

Uniform Division of Income for Tax Purposes Act, 7A UNIFORM LAW ANNOTATED 331 (1985)

§ 1(a) 28

§ 1(e) 28

§ 18 29

MISCELLANY:

J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES (1983)

¶ 7.2 p.266 24

¶ 9.2 p.481 29

¶ 9.4 pp.488-91 29

¶ 9.12[2] p.551 5

W. Hellerstein, *State Income Taxation of Multijurisdictional Corporations and the Supreme Court*, 35 NAT'L TAX J. 401 (1982) 5

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Unitary Business Defined, 4:8 MULTISTATE TAX ANALYST (Oct. 1989) 5

1 1990 MULTISTATE CORP. INCOME TAX GUIDE ¶167 (CCH 1991) 29

No. 91-615

In The
Supreme Court of the United States
October Term, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,
v.
DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the
Supreme Court of New Jersey

BRIEF AMICUS CURIAE OF MULTISTATE TAX COMMISSION IN SUPPORT OF RESPONDENT ON REARGUMENT

INTEREST OF AMICUS CURIAE

Amicus will not repeat its previous statement. Br. *Am. Cr.* Multistate Tax Comm'n 1-3. *Amicus* will supplement its statement in light of the Court's announced willingness to revisit the fundamentals of apportioning intangible income in nondomiciliary States.

Amicus believes the unitary business principle critically supports state taxation of multijurisdictional commerce. Nonetheless, confusion has imparted a

quasi-elective quality to the principle for taxpayers under our voluntary, self-assessment system. Additionally, the field experience of States indicates it is difficult, though not absolutely impossible, for states to resist successfully taxpayers desiring to secure unitary or combined treatment for the different segments of their enterprises. These practical realities influence how *Amicus* reacts to proposals for a workable concept of a unitary business. *Amicus* seeks a practical, even-handed statement of the unitary business principle.

SUMMARY OF ARGUMENT

ASARCO and *Woolworth* should be overruled. Three indefensible concepts adversely impacting the unitary business principle are derived from these cases: (i) the view that a unitary relationship between the taxpayer-owner and the issuer of an intangible is essential to support the apportionability of intangible income; (ii) the endorsement of a narrow view of a unitary business within a nondomiciliary State; and (iii) notion that "the potentials of the relationship" will not support a finding of a unitary business. These mistaken concepts may have emanated from an unfounded suspicion and an inadequate record that reflected the realities of state tax litigation involving multinational enterprises. By identifying the state tax system that the Court is upholding with respect to nondomiciliary state taxation of intangible income, the Court will insure against making similar mistakes here.

In the absence of impermissible discrimination, the Constitution permits nondomiciliary states flexibility in dividing the income of multijurisdictional business where the result is not unfair or arbitrary. New Jersey may retain its single entity form of taxation (as a statutorily defined unitary business concept) as long as it is applied logically and consistently. Other States may retain combined reporting and distinct business reporting. In these latter States, a unitary business is indicated by the existence of management organized or poised to referee the activities of its different business segments to ensure operations for the betterment of the integrated whole of the enterprise.

Overruling of *ASARCO* and *Woolworth* should be retroactive, because overruling would not establish a new principle of law or deny taxpayers equity.

ARGUMENT

I. *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED, BECAUSE THEY CONTAIN AT LEAST THREE ERRONEOUS CONCEPTS, WERE POSSIBLY UNFAIRLY INFLUENCED BY AN UNFOUNDED SUSPICION AND AN INADEQUATE RECORD, AND FAILED TO IDENTIFY A WORKABLE STATE TAX SYSTEM WITH RESPECT TO THE APPORTIONMENT OF INTANGIBLE INCOME.

A. *The Court Erroneously (i) Used Language Suggesting An Exclusive Test For Determining The Apportionability Of Intangible Income; (ii) Endorsed Too Narrow A View Of A Unitary Business; and (iii) Disregarded The Probative Value Of Establishing "The Potentials Of The Relationship" Among Affiliated Business Segments.*

At least three concepts derivative of *ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, *reh. denied*, 459 U.S. 961 (1982), and *F.W. Woolworth Co.* v. *Taxation & Revenue Dept.*, 458 U.S. 354, *reh. denied*, 459 U.S. 961 (1982), have unjustifiably poisoned the evolutionary waters of the unitary business principle: (i) the view that the *exclusive* test for determining the apportionability of intangible income in a nondomiciliary State is the presence of a unitary relationship between the operations of the taxpayer and the operations of the issuer of the intangible, *ASARCO, supra*, 458 U.S. at 325, 327; (ii) the endorsement of a narrow view of the scope of a unitary business that is conducted within a nondomiciliary taxing State, *ASARCO, supra*, 458 U.S. at 322 (Idaho silver mining insufficiently connected to Southern Peru's autonomous business); and (iii) the notion that a unitary relationship cannot be established by reference to "the potentials of the relationship" among affiliated business segments. *Woolworth, supra*, 458 U.S. at 363.

Mobil Oil Corp. v. *Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980), did not adopt the concept that appor-

tionability of intangible income in a nondomiciliary State is dependent upon the existence of a unitary relationship between the owner-taxpayer and the issuer of the intangible. *Mobil Oil, supra,* 445 U.S. at 442. Notwithstanding Allied-Signal's invocation of this shibboleth of the multinational corporations, Pet. Br. 23-24, no serious student of state taxation believes the Court really intended to adopt such an absolute rule. *See e.g.*, J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶ 9.12[2] p. 551 (1983); W. Hellerstein, *State Income Taxation of Multijurisdictional Corporations and the Supreme Court*, 35 NAT'L TAX J. 401, 416 *ff.* (1982); *but see Unitary Business Defined*, 4:8 MULTISTATE TAX ANALYST (Oct. 1989). The Court has indicated parenthetically that it never intended the concept to be exclusive. *ASARCO, supra,* 458 U.S. at 307 n.21; *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159, 180 n.19, *reh. denied*, 464 U.S. 909 (1983).[1]

Rejecting the exclusivity of the concept is consistent with the Court's application of the unitary business principle. Identification of the scope of a business enterprise whose income has sufficient connection to the taxing State to be subject to apportionment is dependent upon whether the disputed

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[1]Some state courts will not evaluate the extraneous statements occurring in *ASARCO* and *Woolworth*. State courts in the esoteric realm of applying the unitary business principle as a constitutional limit on state taxation are often literalists. *Corning Glass Works, Inc.* v. *Virginia Dept. of Taxation*, 241 Va. 353, 402 S.E. 2d 35 (1991), *cert. denied*, 112 S.Ct. 277 (1991); *James* v. *Internat'l Telephone & Telegraph Corp.*, 654 S.W.2d 865 (Mo. Banc 1983).

income arose from the same unitary business being conducted in the taxing State. *Container Corp., supra,* 463 U.S. at 166. The examination does not require the presence of a *direct* relationship between the operational activities giving rise to the disputed income and the operational activities occurring within the taxing State. It is sufficient to satisfy fundamental fairness that both sets of activities, otherwise not *directly* related, are nonetheless related by virtue of their occurring within the same unitary business. *See Amerada Hess Corp.* v. *New Jersey Dept. of Treasury,* 490 U.S. 66, 73-74 (1989) (oil producing activities occurring outside of taxing State related to taxing State by virtue of this activity being conducted by a unitary business).

Equally destructive of the unitary business principle is the Court's narrow view of the scope of a unitary business being conducted within a nondomiciliary, taxing State. This narrow view was manifested by the Court's statement that no unitary connection had been established between the Idaho silver mining business and Southern Peru's autonomous [copper] business. *ASARCO, supra,* 458 U.S. at 322. The narrow view was influenced by the Court's then current understanding that "a continuous flow and interchange of common products" were essential to finding a unitary business. *ASARCO, supra,* 458 U.S. at 329-30 n.24. Thus, the Court in *ASARCO* mistakenly concentrated on *directly* connecting the activities occurring within the taxing State to the intangible asset. The Court's error was not to determine first whether holding of the intangible

asset and the activities occurring within the taxing State, both seemingly distinct, were otherwise integrated into the whole of ASARCO, or into a unitary business. The Court's improper narrow view also carried over to the Court's overreaction to the corporate business purpose test.[2]

Fundamentally, the Court proceeded from an incorrect premise in *ASARCO*. A unitary business is defined, not by the specific activities that are occurring within the taxing State, but by the scope of the business that is being operated as an *integrated whole*. Since *Adams Express Co.* v. *Ohio*, 165 U.S. 194, 222 (1897), the focus of the Court has been on a unity of use and management that results in integration of the segments of the enterprise that otherwise are claimed to be separate and distinct. *Butler Bros.* v. *McColgan*, 315 U.S. 501, 508 (1942); *Container Corp.*, *supra*, 463 U.S. at 179. The telltale sign of a unitary business is the sharing or exchange of value not capable of precise *identification* or *measurement*. *Id.*, 463 U.S. at 166. The sharing or exchange of value is present, or at least has the potential to be present, when the management of the enterprise is organized or poised to ensure that different business

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[2]State tax administrators do not believe the Court understood Idaho's argument. *ASARCO*, *supra*, 458 U.S. at 325-27. Idaho argued that if the ownership of an intangible is in furtherance, or an integral part, of the corporate purpose *of the unitary business being conducted in the taxing State*, then the intangible income is apportionable. *Amici* California *et al.* nicely rephrase the proper expression of the corporate purpose test as the unitary purpose test. Cal. *et al. Am. Br.* Rearg. 20-21.

segments operate cooperatively for the betterment of the whole and not individually without regard to the interest of the whole. A continuous flow and interchange of common products is not required.[3] *Container Corp., supra,* 463 U.S. at 178 n.17.

Allied-Signal's beauty shop/parking lot example, Tr. Oral Arg. 8-9, can be used to demonstrate the fallacy of defining a unitary business narrowly by examining for a *direct* relationship between the operational activities occurring within the taxing State and the operational activities giving rise to the intangible income. Assume with respect to the example that the shift in business focus to the parking lot operation was based upon the informed judgment of management that a better rate of return could be achieved by California parking lots than New Jersey and New York beauty shops. Assume further, however, that if capital improvements were made to the New Jersey and New York beauty shops (say renovation of the ambiance from a worn out 60's motif to a 90's modern music motif), the return of the beauty shops would substantially improve.

These assumptions that seem realistic and may even bear some resemblance to what occurred in this case suggest that the shift in business focus would result in a subordination of the beauty shops' specific

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[3]Neither is the scope of a unitary business defined by the capacity of separate accounting to source income accurately. *Butler Bros.* v. *McColgan,* 315 U.S. 501 (1942). If the enterprise is unitary, separate accounting by definition is inherently imprecise. *Exxon Corp.* v. *Dept. of Revenue of Wisconsin,* 447 U.S. 207 (1980).

interest in favor of the new parking lots. The subordination would occur for the greater good of the integrated whole of the enterprise. This kind of subordination necessarily creates a transfer of value not capable of precise identification or measurement.

One valid way to describe the expanded example that reveals the transfer of value is to note that in effect the beauty shop operation in New Jersey and New York has made a constructive loan to the parking lot operation in California for which it will receive no compensation. This transfer, while not having *federal* tax significance, because the federal tax code operates nationally without restriction as to the boundaries of the States, has tremendous *state* tax significance. Without deviating substantially from federal tax conformity by attempting to account separately for these kind of imputed transactions within a single corporation or an affiliated group of corporations, the States are left with developing a pragmatic solution. Determining the extent of apportionable income by reference to the existence of management that is organized or poised to ensure that individual business segments operate for the benefit of the integrated whole of the business enterprise provides the practical answer. The parking lot income is properly attributable to the states in which the beauty shops are located but only by reference to the apportionment factors of the entire business enterprise present in the taxing State. This result is fair, because these factors, after all, will have in a real sense supported the acquisition of the parking lots.

The only rejoinder the Court appears to have to this argument is its characterization of the intangible income in *ASARCO* as arising from a passive investment. *Container Corp.*, 463 U.S. 177 n.15. Yet the identification of taxpayer's ownership of intangible property as a "passive investment" states only a *conclusion* that the income generated by the intangible is not apportionable (at least under the domiciliary tax system apparently being upheld in *ASARCO*). *Cf. Mobil Oil, supra,* 445 U.S. at 445. A proper *method of analysis* for determining whether the ownership of a particular intangible is a so-called "passive investment" is to ascertain whether *the ownership* of the intangible is connected in the due process sense to the integrated whole of the business enterprise, part of which is being conducted in the taxing State.[4]

The required determination cannot be made without *first* identifying the scope of business activities that are within the integrated whole, or the unitary business, of the enterprise. *Container Corp., supra,* 463 U.S. at 169. Identification of individual, operational activities occurring within the several States does not indicate whether these separate activities are integrated through management that referees among the segments of the enterprise for the betterment of the whole. To determine the

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[4]It would still be a proper due process test to ask whether the issuer of the intangible was in a unitary relationship with the owner-taxpayer. But this inquiry should not be the *exclusive* method of constitutional analysis for determining the apportionability of intangible income.

existence of a unitary relationship simply by reference to the operating activities without asking whether those operating activities fit into the integrated whole of the enterprise is to fail to define the scope of the unitary business. The dissent in *ASARCO* was correct in *first* identifying the unitary business, part of which was conducted within Idaho, as "nonferrous metals" and tying thereafter that unitary nonferrous metals business to ASARCO's ownership of the corporate stock of companies related to that very industry. *ASARCO, supra,* 458 U.S. at 340-44. (O'Connor, J., dissenting).

The third erroneous notion that crept into the unitary business jurisprudence from *ASARCO* and *Woolworth* was the Court's position that a unitary relationship cannot be established by reference to "the potentials of the relationship" between the entities that are being examined. *Woolworth, supra,* 458 U.S. at 363. Accordingly, the Court dismissed the existence of occasional oversight in capital structure, major debt, and dividends, as non-operational stewardship activities. *Id.,* 458 U.S. at 369. Additionally, the Court was impressed by the absence of formal managerial ties, *id.,* and the absence of a continuous flow and interchange of common products. *ASARCO, supra,* 458 U.S. at 329-30 n.24.

The fundamental reason that the Court's rejection of the "potentials" as a sufficient basis for supporting a finding of a unitary business cannot stand is that the complaining taxpayer always has the burden of establishing the absence of a unitary relationship, *i.e.,* the

presence of extra-territorial taxation, by "clear and cogent evidence." *Container Corp., supra,* 463 U.S. at 164. The burden must unequivocally remain on the taxpayer, because the examination after all seeks to discover a sharing or exchange of value *not capable of precise identification or measurement*. *Id.*, 463 U.S. at 166. Proof of the existence of the potential for control will suggest possible "implicit control" sufficient to result in an integrated enterprise.[5] *Id.*, 463 U.S. at 177 n.16.

Preservation of the well established burden of proof doctrine with regard to the unitary business principle is critically important to effective state tax administration. Each State in the typical unitary case is taxing only a small slice of the income includible in the preapportionment tax base. There are few cases where the State, as populated as New Jersey or as sparsely settled as Montana, can realistically be expected to propound 237 interrogatories with subparts, take 10 depositions and make document requests. Tr. Oral Arg. 32. It is unrealistic to expect each State to have to delve into *all* the particulars of the relationship between *all* the separate business segments of a multijurisdictional enterprise to identify the specific factual predicates that will support a unitary business finding. This kind of unrealistic examination is uncalled for

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[5]Achievement of a level of integration that will support unitary treatment is not dependent upon the proof of actual communication within management that dictates results. Effective management operates by defining what is expected and then allowing the subordinate managers to achieve those objectives "voluntarily."

when the taxpayer's organization discloses a grouping of business segments that seek to achieve "factors of profitability" from the operation of the business as a whole. *Mobil Oil, supra,* 445 U.S. at 438.

B. *The Results In* ASARCO *And* Woolworth *May Have Been Unfairly Influenced By An Unfounded Suspicion Of The States' Motives And By An Inadequate Record.*

The Court's opinion in *ASARCO* carries a curious undertone regarding a perception that Idaho inconsistently identified the companies includible in the combined group. *ASARCO, supra,* 458 U.S. at 326 n.22. The apparent implication is that Idaho's *inclusion* of certain companies that resulted in the disregard of any dividends as apportionable income and Idaho's *exclusion* of other companies that resulted in the potential inclusion of dividends was revenue driven. *See ASARCO, supra,* 458 U.S. at 312 and 312 n.8 (*wholly* owned subsidiaries whose dividends because of federal tax code conformity would be excluded from the preapportionment base in any event were combined; subsidiaries of under 80% were not combined in some States, including Idaho, because of the problem such ownership would present, citing n. 12 of *Mobil Oil, supra,* 445 U.S. at 435 (federal tax code conformity preserves 15% of dividends of companies owned less than 80% for inclusion in the preapportionment tax base)).

Whether the Court had an unspoken concern about the State's true motives in determining the extent of the combined group, Idaho's actual litigation strategy in *ASARCO* was not revenue driven. Idaho's strategy was to preserve the purity of the combined group, thereby facilitating possible *state* court approval of the use of combined reporting in its first formal test case of that concept. Idaho's concentration in *ASARCO* was directed to defending the selection of the companies it included within the combined group, not to the selection of the companies it excluded. The State did not devote substantial attention to developing a record to support the resulting apportionability of the dividend income that was attributable to the excluded companies. In addition, the small attention the State gave to developing a record on the apportionability of intangible income was accomplished without the State having the benefit of Court's opinions in *Mobil Oil, supra,* and *Exxon Corp.* v. *Dept. of Revenue of Wisconsin,* 447 U.S. 207 (1980).[6]

The State's litigation strategy paid off, because the trial court's decision upholding combined reporting in Idaho was not appealed. *ASARCO, supra,* 458 U.S. at 314. It is not surprising given this reality of the *ASARCO* litigation that the record would not affirmatively reflect in detail how the *ownership* of the

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[6]*American Smelting & Refining Co.* v. *Idaho State Tax Comm'n,* 99 Idaho 924, 592 P.2d 32 (1979), predates both *Mobil Oil* and *Exxon Corp.*

excluded companies related to ASARCO's unitary business. The absence of a fully developed record was fatal to Idaho, because the Court placed so much emphasis on the necessity for affirmative facts and findings.[7] The implausibility of the conclusion reached in *ASARCO* confirms the lack of attention that was given to the record. It simply is not realistic to believe that a publicly held, multinational company whose financial results are directly affected by its ownership interests would have both a totally "hands-off" approach and a passive investment mentality with respect to companies operating within its own industry.

Woolworth reflects a similar reality of litigation. The total New Mexico assessment (which involved other revenue matters, including interest) was $16,478. J.A. in No. 80-1745, p. 67a. As a sparsely settled State with a relatively small economy, it is not surprising that New Mexico limited its efforts. The challenge a *State* faces to develop a "full" record to support a unitary finding with respect to a resistant multinational company which controls the facts and whose relevant records are spread out over the world cannot be overstated. After all, the

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[7] *Container Corp., supra,* 463 U.S. at 176-77 n.15 and 179 n. 18; *ASARCO, supra,* 458 U.S. at 322 (findings and undisputed facts), 325 n.21 (dissent's perception of facts differs; trial court's findings noted; dissent's description at odds with undisputed facts), 327 n.22 (facts differ), and 329 n. 24 (cases decided on facts). The same observations pertain to *Woolworth, supra,* 458 U.S. at 360 (Court notes poor record developed), 362 (dividend *in fact* derived from unrelated business enterprise), 364-69 (review of the facts) and 369 (conclusion reached on basis of undisputed facts).

Internal Revenue Service needs extraordinary provisions to deal with international commerce. *See e.g.*, 26 U.S.C.A. §6038A (West Supp. 1992).

These observations are particularly pertinent because the Court has announced a willingness to reexamine the system of taxation that should govern the division of income of intangible income in nondomiciliary states. If the Court's real concern in *ASARCO* was the inconsistency of application of the unitary business principle, then the Court should focus on developing a statement of the unitary business principle that is clear, reasonably administrable and even-handed. Certainly a State employing combined reporting should not be permitted to exclude business segments arbitrarily from the unitary business to achieve a better revenue effect. But requiring a "logically consistent" unitary business concept is something far less than the adoption of the unrealistic and restrictive standard suggested by *ASARCO* and *Woolworth*. *See Container Corp., supra,* 463 U.S. at 167 (Court notes with apparent approval the existence of variations in the unitary business concept that are "logically consistent").

C. *The Court Should Identify The State Tax System Or Systems It Seeks To Uphold Regarding The Apportionability Of Intangible Income.*

The errors of *ASARCO* and *Woolworth* would have been avoided, if the Court had identified precisely the state tax system or systems it was upholding with

respect to the division of intangible income among the States. The Court's third question indicates that the Court may now be prepared to make this identification. State tax administrators are particularly pleased to see the third question of the Court, because it has the potential to draw taxpayers out of the abstract world of arguing what constitutes a unitary business to identifying precisely where the intangible income should be taxed, if at all. Justice O'Connor clearly wanted the Court to identify the state tax system that should govern the apportionability of intangible income. *ASARCO, supra,* 458 U.S. at 344-49 (dissenting opinion). The Court, having asked the third question, is unlikely to commit the error it did in *ASARCO* and *Woolworth*.

II. *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED RETROACTIVELY, BECAUSE UNDER *CHEVRON OIL CO.* v. *HUSON,* 404 U.S. 97 (1971), SUCH A HOLDING WOULD NOT ESTABLISH A NEW PRINCIPLE OF LAW AND *ASARCO* AND *WOOLWORTH* DID NOT ESTABLISH ANY DEFENSIBLE CONSTITUTIONAL PRINCIPLE UPON WHICH TAXPAYERS COULD HAVE EQUITABLY RELIED.

Others filing briefs in support of Respondent in this supplemental proceeding have adequately discussed the Court's second question. *Amicus* supports the adoption of the test in *Chevron Oil Co.* v. *Huson,* 404 U.S. 97 (1971), even in cases of the Court involving possible expansion of state tax authority. *But cf. McKesson Corp.*

v. *Div. of Alcoholic Beverages & Tobacco*, 110 S.Ct. 2238, 2252 n.23 (1990). The overruling of *ASARCO* and *Woolworth* should be fully retroactive in view of the inherent weakness of *ASARCO* and *Woolworth* as precedent, the highly factual nature of the Court's rulings, and the severe restrictions placed on their applicability following *Container Corp., supra.* An overruling would not establish a new principle of law. Neither case established any defensible constitutional principle upon which taxpayers could have equitably relied. An overruling removes dead underbrush.

III. THE CONSTITUTION PERMITS STATES TO APPORTION INCOME IN ACCORDANCE WITH THE FORMAL IDENTITY OF SEPARATELY ORGANIZED BUSINESS ENTITIES AS WELL AS TO EMPLOY OTHER THEMES OF A UNITARY BUSINESS INVOLVING THE USE OF COMBINED REPORTING AND/OR DISTINCT BUSINESS REPORTING.

A. *The Constitution Permits States To Fashion Logically Consistent Approaches To Dividing The Income Of A Multistate Business That Do Not Produce Arbitrary And Unfair Results.*

The Due Process and Commerce Clauses describe the constitutional outer limits of a state's power to tax income earned by a business operating within the several States (whether derived from the sale of goods and services or from the ownership of intangibles).

These principles, as set forth by this Court in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977), and *Container Corp., supra*, set forth a four prong test.[8] And Allied-Signal has made clear that its complaint in this case is with the first prong based upon its readings of *ASARCO* and *Woolworth*.

However, as vindicators of the constitutional protection against extra-territorial state action, *ASARCO* and *Woolworth* strangely intrude on state tax sovereignty where the contesting taxpayers were admittedly doing substantive and purposive business in the taxing States. *See Nat'l Geographic Society* v. *California Bd. of Equalization*, 430 U.S. 551, 561 (1977) (use tax collection responsibility is premised on unrelated in-state activity); *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 344-45 (1954) (some definite link, some minimum connection between the state and the person, property, *or* transaction supports jurisdiction); *Internat'l Shoe Co.* v. *Washington*, 326 U.S. 310, 316 (1945) (concern is traditional notions of fair play and substantial justice).

Fortunately, with respect to claims of extra-territorial taxation, taxpayers have the burden to establish

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[8]The four prong test requires any state income tax to be imposed on those doing interstate business to be (i) imposed upon a taxpayer or transaction with which the state has a sufficient nexus or minimum connection; (ii) fairly apportioned to the state in terms of the tax imposed meeting the internal and external consistency tests; (iii) nondiscriminatory against interstate commerce; and (iv) fairly related to the services provided by the state.

that the resulting tax was arbitrary and unconstitutional. *Container Corp., supra,* 463 U.S. at 175, citing *Norton Co.* v. *Dept. of Revenue,* 340 U.S. 534 (1951). A failure of such proof leaves the States free to fashion any logically consistent solution to solving the problem of dividing the income of a multistate business that has nexus with the taxing State. Variants of the unitary business principle are permitted. *Container Corp., supra,* 463 U.S. at 167-69, 178 n. 17; *Moorman Mfg. Co.* v. *Bair,* 437 U.S. 267, 279 (1978) (Constitution is neutral). The Due Process and Commerce Clauses do not mandate a judicially developed national state tax code, *id.*, 437 U.S. at 275, 279-80, because it would unjustifiably exclude the interests of all the States. *Id.* These considerations have led the Court to defer to Congress.[9]

Under these principles the Court may uphold the system of taxation employed by New Jersey as a constitutionally permitted variant of the unitary business concept. Approval of the New Jersey system would not affect other States' use of the unitary business concept to support combined reporting and/or the distinct business reporting that may break apart affiliated business segments.[10] Thus, a taxpayer has no right to choose

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[9]Impermissible discrimination against protected commerce (*e.g.*, burdensome multiple taxation) may be regulated without congressional legislation. *Mobil Oil, supra,* 445 U.S. at 447. Allied-Signal does not claim impermissible discrimination, however.

[10]Combined reporting and distinct business reporting are noted by the Court in *U.S. Steel Corp.* v. *Multistate Tax Comm'n,* 434 U.S. 452, 473 n.25 (1978), and *Container Corp., supra,* 463 U.S. at 167 and

which of the constitutionally permissible systems of taxation it wants applied in any particular State.

B. *New Jersey's System Of Taxation That Fully Apportions The Income Of Separately Organized Business Entities With Nexus In The Taxing State Provides Fundamental Fairness.*

New Jersey's system of taxation can be legitimately described as a logically consistent variant of the unitary business principle. *Container Corp., supra,* 463 U.S. at 168 n.5. Thus, New Jersey in effect statutorily defines a unitary business as the entire business conducted by each separate business entity. If the entity has nexus with New Jersey, New Jersey apportions the entity's entire income. This *de facto* statutory definition of the unitary business provides taxpayers with fundamental fairness.

New Jersey's system of taxation recognizes that all the property of a single business entity is presumably being "held and used for the purposes of its business." *Adams Express Co.* v. *Ohio State Auditor,* 165 U.S. 194, 227 (1897). The statutory presumption is consistent with a reasonable assessment of economic reality, not only because the record in this case has demonstrated that modern business operates on this premise, *e.g., How Companies Should Use Their Cash,* THE NEW YORK TIMES Section 3, p. 2 (April 25, 1982), Ex. D-19 to Depo. of

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167 n. 2.

Agee (J.A. 134), but also because the very inclusion of property within a single business entity necessarily presupposes a management that operates for the benefit of the entire integrated whole of the corporation. Management of the single business entity, which by definition is central, in all probability is grounded in operational expertise and *overall* operational strategy. *Container Corp., supra,* 463 U.S. at 180 n. 19. Thus, for example, where management within a single entity raises and allocates capital, it necessarily does so on the strength of, for the greater good of, and to the aggregate liability of the entire entity. A non-arm's length flow of capital resources among the segments of the single entity is obvious. *See Container Corp., supra,* 463 U.S. at 180 n.19.

While different segments within a single entity might be found in a rare circumstance to operate distinctly, this theoretical possibility does not preclude New Jersey's logically and consistently applied concept of full apportionment. New Jersey accepts both the good and the bad of its choice to recognize the separate identity of different business entities. One good aspect, benefitting both taxpayer and state tax administrator, is the avoidance of expensive and complicated factual inquiries. One bad aspect is that New Jersey forgoes complaint about the apportionment of losses or deductions into New Jersey that occur within the confines of a single entity. (Bendix directly benefitted from this rule by deducting against its preapportionment New Jersey tax base the interest expense of its debt financed acqui-

sition of ASARCO. Tr. Oral Arg. 46.) Further, New Jersey does not employ combined reporting to "apportion in" income of business entities lacking nexus which are engaged in the same unitary business. Resp. Br. 13. In the face of these *consistent* concepts, it would be *inconsistent* to require New Jersey to accept a single business entity's attempt to disassociate a segment of its income from the taxing State.

In addition, the fairness of the New Jersey system clearly is underscored when one realizes that all Allied-Signal's predecessor-in-interest apparently had to do to avoid taxation of the disputed gain in this case was to move the ASARCO interest out into a separately organized corporation that had no nexus with New Jersey. Taxpayers undoubtedly are becoming increasingly aware of the state tax manipulation potential of these kind of business reorganizations. Rosen, *Use of Delaware Holding Company to Save State Income Taxes*, 20 TAX ADVISOR 180 (March 1989); Stevens, *Delaware Sub. Can Still Reduce Tax But More Planning Needed*, 2 J. MULTISTATE TAX'N 4 (March/April 1982).

C. *The Constitution Additionally Permits Other States To Employ The Unitary Business Principle That Is More Expansive Than What Is Suggested In* ASARCO *and* Woolworth *To Support Combined Reporting And/Or Distinct Business Reporting.*

Many States eschew New Jersey's single entity system of taxation in favor of using the unitary business

principle to support combined reporting and distinct business reporting. These alternative reporting methods avoid manipulative tax planning that has no economic substance.[11] These possibilities support the Court's view that the form in which a segment of the unitary business is being held does not limit the scope of the unitary business. *Mobil Oil, supra,* 445 U.S. at 440.

As has been previously noted, *see* pp. 6-9, *supra,* the appropriate test for determining the scope of a unitary business is to define which of the different business segments within an enterprise are integrated, *i.e.,* "refereed" by management that is organized or poised to ensure that the different segments of an enterprise are operated for the benefit of the whole and not individually. Any enterprise so structured, is likely to

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[11]The potential for organizational restructuring is increased significantly by the federal tax conformity of state corporate income tax systems. *Conformity to Federal Rules for Determining Taxable Income and Income Tax Rates,* 1 1992 MULTISTATE CORPORATE TAX GUIDE I-53 to I-61 (1992); J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶ 7.2 p.266, (1983). Numerous non-recognition provisions exist in the federal tax code without regard to their effect on state taxation.

Two simple examples illustrate the point. Assume that the taxing State in *Butler Bros., supra,* employed separate entity taxation similar to what New Jersey employs. In the absence of combined reporting, a taxpayer could avoid the results achieved in *Butler Bros.* by the single expedient of separately incorporating the several warehouse operations and ensuring that the operations outside the taxing State developed no nexus with that State. Similarly, a business enterprise desiring to apportion losses or deductions into the taxing State could ensure that result in a single entity state by moving the losses or deductions into the single corporation that had nexus with that State.

achieve "the subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container Corp., supra,* 463 U.S. at 164-65. And if the unitary business principle is to be administrable in the context of state taxation of multi-jurisdictional commerce, "the potentials of the relationship" should be seen as supporting a unitary business finding. Requiring proof of actual transfers of value is inappropriate where the risk being guarded against is the nontaxation of income attributable to "a sharing or exchange of value not capable of precise identification or measurement."[12] *Container Corp., supra,* 463 U.S. at 166. *See* pp. 6-9, *supra.*

Application of these principles to a *single* entity, even in states employing combined reporting and distinct business reporting, is likely to support a unitary finding for all sets of activities being conducted within the entity. *See* pp. 21-22, *supra,* which sets forth with respect to the single entity states why this is so based upon economic reality of the circumstances. *Amicus* thus concludes that application of the test proposed in

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[12]This test would eliminate the attempts of taxpayers to segregate so-called excess cash into investment operations that they claim thereafter no longer relate to the operational aspects of their business. *E.g., American Home Products Corp.* v. *Director, Div. of Taxation,* 11 N.J. Tax 287 (Tax Ct. 1990), *app. pending,* N.J. Super. Ct., No. A-4316-90T3. Retention of the cash impeaches the contention. *Cf.,* 26 U.S.C. §531 (1988). Also, no one seriously believes cash managers are allowed to make investment decisions without an eye on the entire enterprise, including the potential needs of the enterprise's separate, operational segments.

a state employing the unitary business concept to support combined reporting would not change the results here. The ownership (*i.e.*, acquisition, management, and disposition) of the ASARCO interest was part of the unitary business of Bendix, part of which was conducted in New Jersey. *See* Br. *Am. Cr.* Multistate Tax Comm'n 13-20.

Notwithstanding these observations, the Court should clearly state that both taxpayers and state tax administrators are free to establish in combined reporting States that different operations within a single business entity are not integrated into a unitary business. While the possibility of this circumstance occurring is low, the logical consistency prescribes the retention of the possibility and indeed stands guard against abusive use of a flat rule that all activities of a single business entity are unitary within a State employing combined reporting.[13] *See* n.11, *supra*.

D. *Any System of State Taxation Allied-Signal Would Propose For Taxing Intangible Income Is Not Constitutionally Required.*

It is not clear what system of state taxation Allied-Signal seeks to uphold. Justice O'Connor's prior identification and refutation of the three possibilities,

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[13]New Jersey with its system of single entity reporting has decided at this stage that it is willing to live with the potential of abuse where at least the form of business coincides with economic substance.

ASARCO, supra, 458 U.S. at 344-49 (dissenting opinion), demonstrates the debilitating impact any of three would have on State taxation. This debilitation disqualifies the three from being considered constitutionally required solutions in a case involving no claims of impermissible discrimination. Before concluding, however, *Amicus* will respond specifically to any contention that States are constitutionally required to adopt a system of allocation based upon the concept of domicile.[14]

There is no support for allocation of income based upon domicile as a constitutionally required system. First, the system is based upon an absolute fiction insofar as it pertains to intangibles. As a result, the Court has not recognized the property tax concept upon which this system is based as being constitutionally required in state income taxation. *Mobil Oil, supra,* 445 U.S. at 443-46.

Second, there is little to indicate today that duplicative state taxation, the goal sought to be resolved in property taxation, is a pressing problem of federalism with respect to corporate income taxation. *See* Br. *Am. Cr.* Multistate Tax Comm'n 24 n.8 (cont'd). Indeed, the Constitution flexibly allows for the possibility of duplicative income taxation, because of the inherent problems

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[14] *Amicus* focuses on this possibility, because it appears as Allied-Signal's most likely candidate. The separate investment *business* possibility does not seem a likely candidate in view of Allied-Signal's hard line position that the ASARCO gain did not arise from operations. *See, e.g.,* Pet. Br. 29.

in actually resolving duplicative taxation. *Container Corp., supra,* 463 U.S. at 188, 192-93.

Third, business does not perceive the income it realizes from intangibles as being qualitatively different from income realized from selling its product. *How Companies Should Use Their Cash, supra.* The States should have the option to treat all income from a business as apportionable, as opposed to allocable, income. The *state* law distinction of business/nonbusiness income of the Uniform Division of Income for Tax Purposes Act §§ 1(a) and (e), 7A UNIFORM LAW ANNOTATED 331, 336-37 (1985) ("UDITPA"), is not constitutionally required.[15]

Fourth, adoption of allocation, as opposed to apportionment, as the constitutional limit proceeds backwards.[16] What little remains of state income tax

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[15]To say that the distinction is not constitutionally required is not the same thing as saying it would be unconstitutional to provide for the distinction. States have flexibility in this area. *See* pp. 18-21, *supra.*

[16]The deficiency of allocation rules is easily demonstrated. Assume a corporation commercially domiciled in State A holds a parcel of real estate in State B for purely passive investment purposes. (The assumption is that the parcel of real estate is not related to any ongoing business being conducted by the corporation.) Assume further that State B that attributes gain for this kind of passive investment real estate to the State where the property is located. Assume also that State B attributes gain arising from the sale of intangibles, such as passive investment corporate stock, to the State of commercial domicile of the owner/seller of that stock. By converting the real estate into stock, which can be accomplished tax-free under state tax codes conforming to the federal tax code, a taxpayer can shift where the gain realized from

rules that allocate, as opposed to apportion, income can be seen as residual holdovers of an earlier era when constitutional concepts impeded the States from raising their fair share of income from interstate business.[17] It seems a reasonable probability that given sufficient indication from the Court, the States may well abandon the use of residual domiciliary based allocation rules as a state law concept in the corporate income tax area. This abandonment would in all probability include even UDITPA's limited business and nonbusiness income distinction. In the meantime, state tax systems typically authorize taxpayers to seek relief from specific division of income rules where their application does not fairly represent the extent of the taxpayer's activity in the taxing State. *E.g.*, UDITPA, *supra*, §18. This common escape valve provides a method to address rare instances of burdensome, duplicative state taxation.

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the sale of the passive investment real estate will be recognized.

Given this and other inherent limitations of specific allocation, J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶9.2 p. 481 (1983), it is not surprising that States would move away from it. Following *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 459-62 (1959), that answered unequivocally for the first time that nondomiciliary states could impose a nondiscriminatory income tax on an exclusively interstate business, States have embraced apportionment. *Compare State Taxation of Interstate Commerce*, H.R. REP. NO. 1480, 88TH CONG., 2D SESS., PT. II, 197-217 (June 15, 1964) (describing then existing allocation practices of the States) *with* 1 1990 MULTISTATE CORP. INCOME TAX GUIDE ¶167 (CCH 1991).

[17] *See* J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶9.4 pp. 488-91 (1983).

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests the Court to affirm the decision below and in doing so should recognize the rights of the States to employ a logically consistent concept of a unitary business that permits both the single entity approach and the combined reporting and distinct business reporting approach.

Respectfully submitted,

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April 8, 1992

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF GENERAL MOTORS CORPORATION, PHILIP MORRIS COMPANIES INC., and HALLMARK CARDS INCORPORATED AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

	Page
INTEREST OF *AMICI CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT	3
I. THE UNITARY BUSINESS PRINCIPLE IS A WELL-ESTABLISHED STANDARD ON WHICH MULTISTATE AND MULTINATIONAL CORPORATIONS RELY IN STRUCTURING THEIR OPERATIONS	3
II. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED	4
A. The Unitary Business Principle	5
B. The Commerce Clause v. The Due Process Clause	12
III. IF *ASARCO* AND *WOOLWORTH* WERE OVERRULED, WHAT CONSTITUTIONAL PRINCIPLES SHOULD GOVERN STATE TAXATION OF INTERSTATE COMMERCE?	14
CONCLUSION	17

TABLE OF AUTHORITIES

Constitution: Page

Commerce Clause of the United States Constitution, art. I, § 8, cl. 3 ..... *passim*

Equal Protection Clause of the United States Constitution, amend. XIV, § 1 ..... *passim*

Cases:

ASARCO, Inc. v. *Idaho State Tax Comm'n*, 458 U.S. 307 (1982) ..... *passim*

Bass, Ratcliff & Gretton v. *State Tax Comm'n*, 266 U.S. 271 (1924) 4

Butler Bros. v. *McColgan*, 315 U.S. 501 (1942) 3

Commonwealth Edison Co. v. *Montana*, 453 U.S. 609 (1981) 16

Complete Auto Transit, Inc. v. *Brady*, 430 U.S. 274 (1977) 14,15,16,17

Corning Glass Works, Inc. v. *Virginia Dep't of Taxation*, 241 Va. 353, *cert. denied*, 112 S. Ct. 277 (1991) 4,9,10,14

Container Corp. v. *Franchise Tax Bd.*, 463 U.S. 159 (1983) 4,7,10,14

F.W. Woolworth Co. v. *Taxation & Revenue Dep't*, 458 U.S. 354 (1982) ..... *passim*

Kraft General Foods v. *Iowa Dep't of Revenue*, No. 90-1918 11,16

Mobil Oil Corp. v. *Commissioner of Taxes*, 445 U.S. 425 (1980) ..... *passim*

Northwestern States Portland Cement Co. v. *Minnesota*, 358 U.S. 450 (1959) 5

Pledger v. *Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark.), *cert. denied*, 112 S. Ct. 418 (1991) 4,10

Table of Authorities Continued

Page

Underwood Typewriter Co. v. *Chamberlain*, 254 U.S. 113 (1920) 4

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BRIEF OF GENERAL MOTORS CORPORATION, PHILIP MORRIS COMPANIES INC., and HALLMARK CARDS INCORPORATED AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

This brief is submitted by *amici curiae* in response to this Court's invitation to address the three questions posed in its order of March 11, 1992. This brief will address this Court's first and third questions.

INTEREST OF *AMICI CURIAE*

Amici are multistate, multinational corporations engaged in different lines of business throughout the country and abroad. Their common interest is in the manner in which the income they earn from active business operations and passive investments is taxed

by the various states. The outcome of the instant case could directly affect their exposure to taxation both by their respective states of domicile and by all non-domiciliary states in which they engage in business in one form or another.

SUMMARY OF ARGUMENT

Amici strongly urge this Court to preserve the fundamental elements of the unitary business principle that have served as the touchstone for an entire line of decisions ranging over almost 100 years, and that have come to be understood and applied in a generally uniform manner by state courts and state taxing authorities throughout the country. To the extent that it is believed that *ASARCO, Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co.* v. *Taxation & Revenue Department*, 458 U.S. 354 (1982), reached the wrong result on the facts there presented, this Court need only so indicate in its decision in the instant case. There is no need to overrule those decisions.

An express overruling of *ASARCO* and *Woolworth* would inevitably be interpreted by state taxing authorities as the placement of this Court's imprimatur on a vastly expanded unitary business concept under which virtually all of a corporation's activity, including unrelated lines of business and investments, could be characterized as part of a single unitary business based on the most tenuous of links. Such a result would create overwhelming confusion in the area of state taxation. Substantial exposure of multistate corporations to double taxation and uncertainty regarding the validity of existing apportionment formulas are but two of the myriad of problems that

would be created by a major erosion of the basic unitary business concept.

Amici also see no reason for this Court to conclude that the Commerce Clause rather than the Due Process Clause of the Fourteenth Amendment should control in the area of state taxation of interstate commerce. This Court must recognize that the standards applicable under the Commerce Clause are at least as stringent regarding a state's power to tax interstate commerce as those developed under the Due Process Clause. In addition, whether or not this Court decides to overrule *ASARCO* and *Woolworth*, a Fifth Amendment Due Process claim could still be made—and would necessarily be separately evaluated—if Congress were to enact federal legislation regulating state taxation of interstate commerce. Thus, *amici* respectfully question whether any real purpose would be served by overruling *ASARCO* and *Woolworth* merely to give preeminence to the Commerce Clause in this area.

ARGUMENT

I. THE UNITARY BUSINESS PRINCIPLE IS A WELL-ESTABLISHED STANDARD ON WHICH MULTISTATE AND MULTINATIONAL CORPORATIONS RELY IN STRUCTURING THEIR OPERATIONS

The unitary business principle dates back to the 19th century. ("At least since *Adams Express Co.* v. *Ohio*, 165 U.S. 194 [(1897)], this Court has recognized that unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis." *Butler Bros.* v. *McColgan*, 315 U.S. 501, 508 (1942).) This Court has long applied

the principle to state taxes measured by net income. *See, e.g., Bass, Ratcliff & Gretton* v. *State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920).

Over the years, the unitary business principle has evolved into a well-established norm to which state legislators have adapted and state courts have generally been faithful. *See, e.g., Corning Glass Works, Inc.* v. *Virginia Dep't of Taxation*, 241 Va. 353, *cert. denied*, 112 S. Ct. 277 (1991); *Pledger* v. *Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark.), *cert. denied*, 112 S. Ct. 418 (1991). While application of the principle to a particular case requires a very fact-specific inquiry, *see, e.g., ASARCO*; *Woolworth*, its underlying precept—that a state may not impose a tax on "value earned outside its borders," *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 164 (1983), *quoting*, *ASARCO*—has become an integral part of the legal framework that governs the state taxation of interstate commerce. Corporations, such as *amici*, which operate throughout the states and the entire world, have historically relied on the applicability of a substantive unitary business concept in structuring their operations.

II. *ASARCO* and *Woolworth* Should Not Be Overruled

Amici see no reason to overrule *ASARCO* and *Woolworth*. Those cases were two in a line of cases decided by this Court that have applied the "unitary business" principle in testing whether a state taxing scheme has exceeded constitutional limitations. They broke no new ground. *ASARCO* and *Woolworth* are merely representations of just how fact-specific unitary business determinations necessarily must be. If this Court were now to overrule those cases, it would

create overwhelming confusion in an area of the law which this Court itself has described as a "quagmire." *See Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 458 (1959). Multistate and multinational corporations, such as *amici*, would truly be left in the dark as to how best to restructure their operations in what would, for them, be a completely new environment.

Justice O'Connor's dissent in *ASARCO* criticized the majority opinion on two grounds. First, Justice O'Connor strongly disagreed with the conclusion that the investment activity giving rise to the dividend income in question was not a part of ASARCO's unitary business carried on partly in Idaho. *ASARCO*, 458 U.S. at 334-344. Second, Justice O'Connor thought that the decisions should have been reached under the Commerce Clause rather than the Due Process Clause because of a concern that a Due Process decision would effectively preclude Congress from exercising its power to legislate in this area in order to "correct" the result reached. *Id.* at 350 & n.14. An overruling of *ASARCO* and *Woolworth* by this Court would presumably be on one of the foregoing grounds. With all respect, *amici* see no basis for overruling the two cases on these, or any other, grounds.

A. The Unitary Business Principle

Amici recognize that nothing in Justice O'Connor's dissent expressly indicates a desire to eviscerate the role of the unitary business principle as the "linchpin of apportionability." *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 439 (1980). Unfortunately, however, the reasoning of the dissent would leave little remaining of the unitary business concept. Under Justice O'Connor's view, virtually all of a cor-

poration's activity could be characterized as a single "unitary" business if the most limited of connections existed among the activities involved.

For example, in *ASARCO*, Justice O'Connor saw no real distinction between the short-term and long-term investment of corporate capital. *ASARCO*, 458 U.S. at 337-339. If no distinction were to be drawn between short-term and long-term investment, no investments would ever escape unitary treatment. In addition, Justice O'Connor noted that some of ASARCO's investments were made in foreign companies operating in the same line of business as ASARCO but in different geographic markets. Justice O'Connor thought that such geographic diversity provided the company with "profits stability," thereby buttressing the notion that all of ASARCO's interests constituted one unitary business. *Id.* at 342. Under this view, every corporation engaged in more than one type of activity might find its activities treated as a single unitary business because the very diversity of its enterprise might provide it with "profits stability." When one activity was down, another might be prospering. *See id.* at 342. A notion that there is "unity in diversity" would surely be a radical departure from basic unitary business principles if applied merely because "profits stability" might be found.

In *Woolworth*, Justice O'Connor focused on the fact that there were "mail, telephone, and teletype communications between the upper echelons of management of the parent and the subsidiaries," that dividend decisions and substantial borrowing by the subsidiaries had to be approved by the parent, and that the parent's published financial statements were prepared on a consolidated basis. *Woolworth*, 458 U.S.

at 373-374. Those relationships apparently were enough in Justice O'Connor's view to warrant unitary treatment.

Such an expansive view of the unitary business concept would totally undermine this Court's concrete elaboration of the principle in *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159 (1983):

> In addition, the principles we have quoted require that the out-of-state activities of the purported "unitary business" be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation. See generally *ASARCO*, *supra*, at 317, 102 S.Ct. at 3115; *Mobil Oil Corp.*, *supra*, 445 U.S. at 438-442.

463 U.S. at 166. Under the views expressed by Justice O'Connor, virtually any connection between companies owned by a common parent would apparently satisfy the *Container* test, without any regard for the qualitative nature of those connections so clearly contemplated in *Container*.

To take a specific example, assume a holding company sits atop an enterprise carrying on two discrete lines of business through subsidiaries having nothing to do with each other (*e.g.*, mining activity west of the Mississippi and department store operations east of the Mississippi). The mere fact that the holding

company separately and independently manages each line of business has not, without more, generally caused the entire operation to be treated as a single unitary business. Under Justice O'Connor's view, however, a contrary conclusion could easily be reached. (Would consolidated financial statements be enough?) Yet, absent a specific showing of cross-involvement by the parent that warrants treating both lines of activity as part of a single unitary business, it is difficult to comprehend why the mining states should be allowed to tax any portion of the income earned by the department store operations. Surely it cannot be because they are providing any meaningful services or protection for the department stores.

Even if, as *amici* strongly urge, this Court remains committed to preserving separate taxation for separate lines of business where there is no showing of a definite, qualitative "exchange of value" between the businesses, it would still be unclear under Justice O'Connor's reasoning how investment income should be treated. For example, suppose the parent holding company received and invested dividend income from both chains of its subsidiaries while it determined how much to commit to a third line of business and how much to distribute to the stockholders. Would its investment activities be considered part of the mining business, the department store business, both businesses or neither business? How would such a determination be made?

Under present law, the investment income earned in such a situation would very likely be allocated entirely to the holding company's domiciliary state, rather than apportioned among the nondomiciliary states. That is because the nondomiciliary states do

not have sufficient ground for justifying a tax on such income. *Amici* see no constitutional basis for altering that result. More specifically, *amici* see no constitutional justification for allowing the mining states or the department store states to tax the parent company's investment income under the circumstances presented.

It should be apparent, therefore, that if this Court were to signal a dramatic expansion of the unitary business concept through an overruling of *ASARCO* and *Woolworth*, enormous confusion would result. Nondomiciliary states, either by statutory amendment or by interpreting the term "business" income even more broadly than they currently do, would undoubtedly seek through apportionment to tax all passive investment income and, quite possibly, all income from other lines of business not previously thought to be unitary. Meanwhile, domiciliary states would just as likely contend that passive investment income is not apportionable "business" income under their definition of the term, but rather remains subject to their exclusive taxation.

The exposure to possible double taxation is clear. Corporations might even find themselves in the untenable position of having to argue in a nondomiciliary state that their investment activity *was not* unitary and therefore not apportionable, while arguing in their domiciliary state that their investment activity *was* unitary and therefore not entirely allocable to that state. (While there is some possibility of such exposure today, the state courts (if not the state taxing authorities) generally have adhered faithfully to the unitary business principle that this Court has developed over the years. *See Corning Glass Works, Inc.*

v. *Virginia Dep't of Taxation*, 241 Va. 353, *cert. denied*, 112 S. Ct. 277 (1991); *Pledger* v. *Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark.), *cert. denied*, 112 S. Ct. 418 (1991).)

As was noted during oral argument in the instant case, an expansive interpretation of the unitary business principle would also invite corporations with losses in certain lines of business to assert more aggressively their unitary status with profitable lines that previously were taxed on a separate and independent basis. (Tr. of Oral Argument at 43-44.) In such situations, state taxing authorities would very likely find themselves opposing the very unitary treatment they might be seeking in similar situations where all lines of business were profitable.

Finally, an expansive interpretation of the unitary business principle would raise serious questions about the validity of existing apportionment formulas. In *Container*, this Court explained that the factor or factors used in an "apportionment formula must actually reflect a reasonable sense of how income is generated." 463 U.S. at 169. Typically, most states include three factors: payroll, sales, and tangible property, in their apportionment formulas. *Mobil*, 445 U.S. at 453. These factors would not seem even remotely to reflect how investment income from intangible assets is generated. Under *Container*, states are *required* to take into account in their apportionment formulas those factors that generate all unitary business income. Surely that would include passive investment income if this Court moves to treat such income as unitary. At a minimum, that would mean inclusion in the formula of factors such as the investment income itself (as a counterpart to "sales"

income), the intangible assets that produced the investment income, or both, in order properly to apportion dividends, interest, and capital gains among the nondomiciliary states.

Moreover, as Justice Stevens suggested in his dissent in *Mobil*, states might also need to take into account the sales, property, and payroll factors of the dividend payors themselves. *Mobil*, 445 U.S. at 459 ("Clearly it is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income."). Here, the complexities could become overwhelming because an appropriate adjustment to the apportionment formula would be extremely difficult to make. For example, the dividend recipient might not even have access to the information necessary to adjust its apportionment formula if it owned less than a controlling interest in the dividend payor. In addition, the ratio of dividends paid to total earnings of the dividend payor would have to be taken into account. Furthermore, dividend payments do not always mirror current earnings, and may in fact represent a distribution of earnings accumulated years earlier. *Cf. id.* at 460 n.18. As a result, controversies regarding the fair apportionment of dividends and other passive investment income would abound.[1]

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[1] Even an appropriate adjustment to a state's apportionment factors in the case of dividend income would not preclude the possibility of discrimination in the calculation of the tax base. *See, e.g., Kraft General Foods* v. *Iowa Department of Revenue*, No. 90-1918 (pending on certiorari) (foreign subsidiary dividends

Overruling *ASARCO* and *Woolworth* based on a belief that they misapplied the unitary business principle would almost certainly be interpreted by the states as the effective interment of a concept that this Court has embraced for almost 100 years. If the cases were overruled, states might believe they could not be found to have engaged in the taxation of "extraterritorial value" unless they attempted to tax corporations with which they had absolutely no contact whatsoever. Surely this Court's extensive precedent in this area is not destined to be reduced to such a hollow shell.

B. The Commerce Clause v. The Due Process Clause

Amici also see no basis for overruling *ASARCO* and *Woolworth* merely because those decisions rested on Due Process grounds rather than on Commerce Clause grounds. It is not at all clear that the apparent motivation for any such overruling—to ensure that Congress is not precluded from enacting "corrective" legislation in this area if it is so inclined—is valid under the circumstances.

In *ASARCO* and *Woolworth*, a majority of this Court applied Fourteenth Amendment Due Process standards to impose limits on the power of Idaho and New Mexico to tax dividend income found to be earned beyond their borders. The result in those cases in no way prevents Congress, in the exercise of its affirmative power granted under the Commerce Clause, from undertaking to enact federal legislation governing the proper division among the states of

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are included in a corporate tax base while domestic subsidiary dividends are excluded; including factors of foreign subsidiary dividend payors in apportionment formula would not eliminate the alleged discrimination).

income derived from interstate commerce. To be sure, if Congress enacted uniform federal legislation that taxpayers believed was overreaching in allowing states to tax extraterritorial value, taxpayers might well fashion a Due Process argument that would seek to invalidate the legislation, either in toto or as applied in a specific case. Such a challenge, however, would necessarily be a Fifth Amendment, rather than a Fourteenth Amendment, Due Process challenge, and its availability would presumably exist whether *ASARCO* and *Woolworth* were decided on Commerce Clause grounds or on Fourteenth Amendment Due Process grounds.

For example, if Congress passed a law that had the specific effect of allowing Idaho or New Mexico to tax dividend income of the type in dispute in *ASARCO* and *Woolworth*, surely those taxpayers would be free to bring a Fifth Amendment Due Process challenge to that law. The fact that this Court had previously upheld a Fourteenth Amendment Due Process challenge to a *state* law that attempted to tax such income does not in any way compel this Court to follow such precedent in evaluating the constitutionality of a *federal* statute. The findings Congress would make in support of its legislation authorizing the taxation of such income would no doubt weaken any claim that there was an impermissible taxation of extraterritorial values. Due Process protections against federal legislation in this area of state taxation may well be quite different from those afforded when a state itself seeks to expand its taxing powers in the area of interstate commerce. Thus, overruling *ASARCO* and *Woolworth* on the ground that they invoked Fourteenth Amendment Due

Process rather than Commerce Clause protections would seem to be wholly unnecessary.

III. IF *ASARCO* AND *WOOLWORTH* WERE OVERRULED, WHAT CONSTITUTIONAL PRINCIPLES SHOULD GOVERN STATE TAXATION OF INTERSTATE COMMERCE?

As this Court stated in *Container Corp.*, "[u]nder both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.' " *Container Corp.*, 463 U.S. at 164, *quoting*, *ASARCO*, 458 U.S. at 315. This fundamental and overriding constitutional principle must guide this Court in determining the constitutionality of a state tax on interstate business activity even if the focus of its analysis were to shift from the Due Process Clause to the Commerce Clause.

This Court has developed a four-part test to determine whether a state taxing statute satisfies the Commerce Clause. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). This test requires that the tax be (1) applied to an activity with a "substantial nexus" with the taxing state; (2) fairly apportioned; (3) nondiscriminatory; and (4) fairly related to the services provided by the state.

The Commerce Clause's first requirement - "substantial nexus" - would appear to contemplate a greater restraint on state taxing power than the "minimal connection" requirement of the Due Process Clause because the negative Commerce Clause is concerned with state interference with interstate commerce, not merely with state contact with a business enterprise. Any decision by this Court to make the

Commerce Clause the operative Clause for determining the scope of unitary business taxation must, therefore, clearly delineate the scope of the nexus requirement in a manner consistent with the purpose of the negative Commerce Clause.

For the same reason, the second requirement of *Complete Auto* - fair apportionment - may also enjoy greater breadth than under the Due Process Clause. As noted above, an expansive view of what constitutes a unitary business throws into question the validity of today's typical apportionment formulas. At a minimum, the same requirements that have been developed under the Due Process Clause—a rational relationship between the income apportioned to the taxing state and the intrastate values of the enterprise; income apportioned in a manner that is not out of all proportion to the activity performed in the taxing state, *Mobil*, 445 U.S. at 436-437,—must clearly be articulated under the Commerce Clause.

Justice O'Connor's dissent in *ASARCO* appears to suggest that the third prong of *Complete Auto* - nondiscrimination - could actually have served as the basis for the majority's decision. *ASARCO*, 458 U.S. at 350 n.14. In support of this theory, Justice O'Connor quoted the dissent of Justice Stevens in *Mobil*, which explained how a violation of the Due Process Clause could also be a violation of the Commerce Clause.

> If, in a particular case, use of an allocation formula has the effect of taxing income earned by an interstate entity outside the state, it could alternatively be said to have the effect of taxing the income earned by that entity inside the State at a rate higher

> than that used for a comparable, wholly intrastate business, a discrimination that violates the Commerce Clause.

Mobil, 445 U.S. at 452 n.4.

Justice Stevens's argument is premised on the fact that the state's apportionment formula has caused it to tax income earned beyond its borders, *i.e.*, income that is not part of a unitary business being carried on within the state. The argument has validity whenever the apportionment formula leads to that result. If, however, this Court were somehow to conclude that the "nexus" requirement is actually less stringent under the Commerce Clause than under the Due Process Clause, a state would rarely be found to be taxing income beyond its borders. Rather, virtually all income earned by a corporation would be part of its unitary business and the discrimination analysis offered by Justice Stevens would never even be pertinent. Absent a situation such as that involved in *Kraft General Foods*, the discrimination prong of the Commerce Clause would thus appear to provide little or no protection with respect to potential overreaching by states asserting a basis for unitary business taxation.

The final prong of the *Complete Auto* test - the requirement that there be a fair relationship between the activities taxed and the services provided by the taxing state - is totally consistent with, and would seem to add little to what is contemplated by, the "substantial nexus" requirement. *See Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 625-626 (1981). If this Court were to overrule *ASARCO* and *Woolworth* and decide that the Commerce Clause should dictate the scope of unitary business taxation, this

Court should articulate the scope of the final prong of the *Complete Auto* test in a manner that comports with the "substantial nexus" requirement.

CONCLUSION

For the foregoing reasons, *amici* strongly urge this Court not to overrule its decisions in *ASARCO* and *Woolworth* and to reverse the decision below.

Respectfully submitted,

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April 10, 1992

Supreme Court, U.S.
FILED
APR 10 1992
OFFICE OF THE CLERK

No. 91-615

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

ALLIED SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE SUPPORTING REVERSAL

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iii
INTEREST OF AMICUS CURIAE	1
SUMMARY OF ARGUMENT	2
ARGUMENT	5
I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED	5
A. Constitutional Limitations on State Taxation of Multijurisdictional Businesses: Has the State "Given Anything for Which It Can Ask Return"?	5
B. Apportionment Methods and the Overarching Importance of the Unitary Business Principle in Preventing Extraterritorial Taxation	7
C. A Decision to Overrule *ASARCO* and *Woolworth* Would Be A Decision to Repudiate the Unitary Business Principle	11
D. Overruling *ASARCO* and *Woolworth* Would Exacerbate the Potential for Duplicative Taxation	12
E. *Stare Decisis* and the Rule of Law	15
II. ANY DECISION OVERRULING *ASARCO* AND *WOOLWORTH* AND UNDERMINING THE UNITARY BUSINESS PRINCIPLE SHOULD BE WHOLLY PROSPECTIVE	17
III. TOWARD THE DEVELOPMENT OF NEW CONSTITUTIONAL STANDARDS: SAFEGUARDING DUE PROCESS IN THE ABSENCE OF THE UNITARY BUSINESS PRINCIPLE	22

TABLE OF CONTENTS—Continued

	Page
A. The Need for Uniform Definitions and Apportionment Rules	23
B. The Compelling Case for Factor Representation	25
IV. SUMMARY	28
CONCLUSION	29

TABLE OF AUTHORITIES

CASES: Page

Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 8-9, 11
American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue, 442 N.W.2d 629 (Wis. App. 1988) 27
American Trucking Ass'ns v. Smith, 110 S. Ct. 2323 (1990) 19
Arizona v. Rumsey, 467 U.S. 203 (1984) 16
ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) ..... *passim*
Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) 2, 6
Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) 15, 27
Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977) 2, 5, 23
Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932) 16
Butler Bros. v. McColgan, 315 U.S. 501 (1942) 26
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 4, 18, 19
Cipriano v. City of Houma, 395 U.S. 701 (1969) 19
Commissioner v. Wilcox, 327 U.S. 404 (1946) 21
Commonwealth v. Emhart Corp., 278 A.2d 916 (Pa. 1971) 28
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 6
Connecticut General Life Ins. Co. v. Johnson, 303 U.S. 77 (1938) 5, 17
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 3, 8, 10, 22, 26, 28
Cooper v. Aaron, 358 U.S. 1 (1958) 15
Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980) 6, 8, 9, 10
Freeman v. Hewit, 329 U.S. 249 (1946) 6
F.W. Woolworth Co. v. Director of Division of Taxation, 213 A.2d 1 (N.J. 1965) 27
F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354 (1982) ..... *passim*
George, Inc. v. Norberg, 444 A.2d 868 (R.I.), *cert. denied*, 459 U.S. 908 (1982) 28

TABLE OF AUTHORITIES—Continued

	Page
Getty Oil Co. v. Director of Revenue, CCH Del. State Tax Rptr. ¶ 200-286 (Del. Tax. App. Bd. 1975)	28
Hans Rees' Sons, Inc. v. North Carolina ex rel. *Maxwell*, 283 U.S. 123 (1931)	9
Hilton v. South Carolina Public Rys. Comm'n, 112 S. Ct. 560 (1991)	16
Homart Dev. Co. v. Norberg, 529 A.2d 115 (R.I. 1987)	27
Hutto v. Davis, 454 U.S. 370 (1982)	15
James v. United States, 366 U.S. 213 (1961)	21
The Mayor v. Cooper, 73 U.S. (6 Wall.) 247 (1867)	15
McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 110 S. Ct. 2238 (1990)	18-19, 20
Miller Bros. v. Maryland, 347 U.S. 340 (1954)	6
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980)	*passim*
Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978)	8, 13, 16, 23, 24, 25
NCR Corp. v. Comptroller of the Treasury, 544 A.2d 764 (Md. 1988)	27
NCR Corp. v. South Carolina Tax Comm'n, 402 S.E.2d 666 (S.C. 1991)	27
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959)	7, 24-25
Payne v. Tennessee, 111 S. Ct. 2589 (1991)	4, 16, 21
Smith v. Allwright, 321 U.S. 649 (1944)	16
Solem v. Stumes, 465 U.S. 638 (1984)	20
Standard Oil Co. v. Peck, 342 U.S. 382 (1952)	13, 24
State R.R. Tax Cases, 92 U.S. 575 (1875)	3, 8, 11
Swift & Co. v. Wickham, 382 U.S. 111 (1965)	16
Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039 (Me. 1991)	26-27
Trinova Corp. v. Michigan Dep't of Treasury, 111 S. Ct. 818 (1991)	6, 7, 11
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920)	9, 27
United States v. Estate of Donnelly, 397 U.S. 286 (1970)	19

TABLE OF AUTHORITIES—Continued

	Page
Wallace v. Hines, 253 U.S. 66 (1920)	8, 11
Welch v. Texas Dep't of Highways & Public Transp., 483 U.S. 468 (1987)	16
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)	7
FEDERAL CONSTITUTIONAL PROVISIONS:	
U.S. Const. art. I, § 8, cl. 3	2, 5
U.S. Const. amend. XIV, § 1	2, 5
FEDERAL STATUTES:	
Internal Revenue Code (26 U.S.C.) § 78	28
UNIFORM LAWS:	
Uniform Division of Income for Tax Purposes Act	7, 13
MISCELLANEOUS:	
Fallon, Richard H., Jr., and Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 Harv. L. Rev. 1731 (1991)	20-21
Hartman, Paul J., *Federal Limitations on State and Local Taxation* (1981)	6
Rudolph, E. George, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171 (1970)	11, 27

IN THE

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No. 91-615

ALLIED SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE SUPPORTING REVERSAL

INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae*.[1] Tax Executives Institute (hereinafter "TEI" or "the Institute") is a voluntary, non-profit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and currently has approximately 4,800 members who represent more than 2,000 of the leading corporations in the United States and Canada. TEI is dedicated

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[1] Tax Executives Institute has received the written consents of the Petitioner and Respondent to the filing of this brief; those consents have been filed with the Clerk of the Court.

to promoting the uniform and equitable enforcement of the tax laws throughout the Nation and to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers.

The members of the Institute represent a cross-section of the business community in North America, and the multijurisdictional companies represented by the Institute's membership are significantly affected by the rules governing the allocation and apportionment of income among the various States. As a result, nearly all the Institute's members will be directly affected by the resolution of this case. If the New Jersey Supreme Court's decision stands, taxpayers throughout the Nation will suffer from the resulting uncertainty, the increase in the cost and burden of compliance, and the enhanced potential for duplicative taxation. As the individuals who must contend daily with the interpretation and administration of the Nation's tax laws, the Institute's members have a vital interest in the proper disposition of this case.

SUMMARY OF ARGUMENT

Under the Commerce and Due Process Clauses of the Constitution,[2] a State may not tax value outside its borders. Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

This case involves the limitations on the States' power to apportion income of a nondomiciliary taxpayer where that income bears no, or only a marginal, connection with

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[2] U.S. Const. art. I, § 8, cl. 3 (Commerce Clause); U.S. Const. amend. XIV, § 1 (Due Process Clause).

the taxpayer's activities in the State. Due process requires some definite link—or nexus—between the State and the person to be taxed. Without such a connection, the taxing scheme will be struck down as violating both the Due Process and Commerce Clauses.

Apportionment formulae are generally used to determine what part of a taxpayer's income may be properly taxed by the respective States. More than a century ago, this Court held that the taxability of a nondomiciliary taxpayer's out-of-state income turned on the application of the "unit rule" or the unitary business principle—on whether the out-of-state item sought to be taxed was "unitary" with, or functionally related to, the taxpayer's in-state activities. *State R.R. Tax Cases*, 92 U.S. 575, 608 (1875). Twelve years ago, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), the Court encapsulized its prior holdings by declaring the unitary business principle to be the "linchpin of apportionability in the field of state income taxation." Subsequently, this Court decided *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982); and *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983), which reaffirmed the bedrock unitary business principle and established standards for determining whether the requisite link exists between a nondomiciliary taxpayer's business activities within the State and its investments in or income from other nondomiciliary corporations.

The issue here is not simply whether *ASARCO* and *Woolworth* should be overruled, but whether the States are free to apportion all the income of nondomiciliary taxpayers, without regard to whether any connection exists between the State, the income, and the taxpayer's in-state activities. *Amicus* TEI fears that the evisceration of the unitary business principle would convert the current high potential for duplicative taxation into reality.

If these cases were overruled, the same income could well be subject to multiple taxation by various States.

This Court should be loath to overturn the unitary business principle. As it observed last term, "[*s*]*tare decisis* is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991).

Because the repudiation of *ASARCO* and *Woolworth* would constitute a major departure from longstanding principles of Due Process and Commerce Clause jurisprudence, any decision overturning those cases should apply on a prospective-only basis. Such a decision would meet the test for non-retroactive application enunciated in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971); (i) the decision would establish a "new principle of law" that could not have been foreseen by taxpayers; (ii) retroactivity would not vindicate the Due Process or Commerce Clause rights of any of the parties; and (iii) prospectivity would be absolutely necessary to avoid injustice and hardship to the multijurisdictional taxpayers that relied on those cases in good faith.

If *ASARCO* and *Woolworth* were overturned, a balance should be struck between the States' legitimate need for revenues from activities to which the States accord some benefit and taxpayers' legitimate need for, and constitutional right to, protection from taxing authorities that seek to throw a net over income with which the States have no substantial connection. Uniform definitions and apportionment rules would be critical. In the absence of the unitary business principle, judicially prescribed uniformity would be essential to safeguarding the Due Process and Commerce Clause rights of multijurisdictional businesses. In other words, the Court's well-founded reluctance to assume this duty should lead it not to sanc-

tion an "anything goes" approach by the States, but rather to reaffirm the vitality of *ASARCO* and *Woolworth* while inviting Congress to address the matter legislatively.

The decision of the Supreme Court of New Jersey should be reversed.

ARGUMENT

In restoring this case to the calendar for reargument, the Court requested the parties and *amici* to address the following three questions:

- Should the Court overrule *ASARCO* [*Inc.*] *v. Idaho State Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 354 (1982)?
- If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?
- If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several States?

These three questions are addressed seriatim.

I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED

A. Constitutional Limitations on State Taxation of Multijurisdictional Businesses: Has the State "Given Anything for Which It Can Ask Return"?

Under the Commerce Clause and Due Process Clause of the Constitution, a State may not tax value earned outside its borders. *E.g.*, *Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938); *see* U.S. Const. art. I, § 8, cl. 3; U.S. Const. amend. XIV, § 1. Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 335 (1977),

and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935); *see* Paul J. Hartman, *Federal Limitations on State and Local Taxation* §§ 2.2, 2.3 (1981). "State taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." *Freeman v. Hewit*, 329 U.S. 249, 253 (1946).

This case involves the limitations on the States' power to apportion income of a nondomiciliary taxpayer where that income bears no, or only a marginal, connection with the taxpayer's activities in the State. In determining whether a particular state taxing scheme is constitutionally valid, this Court has held that "due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954).[3] Absent a sufficient connection or "nexus" between the State and the person, property, or transaction to be taxed, the "fairness" of the particular levy—whether it is properly apportioned or whether it is reasonably related to the services provided by the State—is irrelevant: it will be struck down as violating both the Due Process

[3] The threshold importance of this "direct link" or "nexus" requirement was reaffirmed by this Court's seminal Commerce Clause decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). That case sets forth a decisional framework for Commerce Clause inquiries that incorporates the Due Process Clause's nexus test as a threshold requirement and then requires a balancing of the competing interests in determining whether the tax infringes on interstate commerce. *Id.* at 279 (the test under the Commerce Clause is whether the tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State"). *See, e.g., Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. 818, 828-29 (1991); *Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 227-28 (1980).

Clause and the Commerce Clause. *See Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. 818, 828-29 (1991); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980). In other words, if the connection is insubstantial or remote, the State has not "given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).[4]

B. Apportionment Methods and the Overarching Importance of the Unitary Business Principle in Preventing Extraterritorial Taxation

In *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), the Court confirmed that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Id.* at 460. Hence, apportionment formulae are used to determine what part of a taxpayer's income may be properly taxed by the respective States. For example, under the Uniform Division of Income for Tax Purposes Act (UDITPA), the apportionment formula compares (i) the taxpayer's property, payroll, and sales (receipts) within the taxing State to (ii) the taxpayer's total property, payroll, and sales. UDITPA §§ 9-17. The purpose of the apportionment formula is to assign to the taxing State the amount of the taxpayer's total income that is earned in, and therefore is reasonably attributable to, the State.

The general permissibility of formulary apportionment, however, should not obscure the Constitution's limitation on the States' ability to tax out-of-state income. As the

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[4] In *J.C. Penney Co.*, the Court framed the inquiry, as follows: "[W]hether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." 311 U.S. at 444.

Court held in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983), "[u]nder both the Due Process and Commerce Clauses of the U.S. Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Id.* at 164, *quoting ASARCO*, 458 U.S. at 315. Consequently, formulary apportionment is permissible only to the extent that the result is a "'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing state.'" *Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 223 (1980), *quoting Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273-74 (1978). *See Wallace v. Hines*, 253 U.S. 66, 69 (1920) (Holmes, J.) (the purpose of formulae based on values both within and without a State is not "to open to taxation what is not within the State," but only to estimate the true values of the things within it).

What connection, or nexus, must exist between a State and a nondomiciliary taxpayer's income from out-of-state sources or activities before that income can be apportioned to the State? More than a century ago, this Court held that this question turned on the application of what has become known as the unitary business principle—on whether the out-of-state item that the State was seeking to tax was "unitary" with, or functionally related to, the taxpayer's in-state activities. In *State R.R. Tax Cases*, 92 U.S. 575, 608 (1875), the Court adopted a "unit rule" under which railroads could be taxed on the apportioned value of their unitary nationwide property. The Court's theory was that the taxpayer's unitary property in each State contributed to and enhanced the value of the property of the whole enterprise. As the Court explained in *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 222 (1897), "while the unity which exists may not be a physical unity, it is something more than a mere unity of ownership. It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but exist-

ing in the very necessities of the case—resulting from the very nature of the business."[5]

Eighty-three years later, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), the Court encapsulized its prior holdings by declaring that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle," *id.* at 439, describing a unitary business as one marked by "functional integration, centralization of management, and economies of scale." *Id.* at 438. The essence of the Court's factual finding in *Mobil* was that the taxpayer had failed to prove that dividend income from foreign subsidiaries (among other sources) was "earned in the course of activities *unrelated to*" its business activities. *Id.* at 439 (emphasis added). The Court explained, however:

> Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business.

Id. at 441-42. *Accord Exxon Corp.*, 447 U.S. at 223, *quoting Mobil*, 445 U.S. at 439.

Subsequently, this Court decided *ASARCO*, *Woolworth*, and *Container*. In the first two cases, the Court concluded that no unitary relationship existed between the States of Idaho and New Mexico, respectively, and the intangible income derived from investments in subsidiaries that those States sought to apportion. The Court found that the subsidiaries were, as a factual matter, " 'discrete business enterprise[s]' that—'in any business or economic sense'—have 'nothing to do with the activities' " of the tax-

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[5] *See Hans Rees' Sons, Inc. v. North Carolina* ex rel. *Maxwell*, 283 U.S. 123, 133 (1931) (unitary business principle gives effect to the Due Process and Commerce Clause requirement that the State's taxing scheme reach "only the profits earned within the state"), *quoting Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

payer in the State. *ASARCO*, 458 U.S. at 328, *quoting Mobil*, 445 U.S. at 439-42. *Accord Woolworth*, 458 U.S. at 372 (each foreign subsidiary operated as a " 'discrete business enterprise,' *Mobil*, *supra* at 439, with a notable absence of any 'umbrella of centralized management and controlled interaction.' *Exxon*, 447 U.S. at 224."). Consequently, the intangible income derived from those subsidaries could not constitutionally be included in the apportionable tax base.

In *Container*, this Court applied the same, self-described "well established" unitary standard to reach the opposite factual conclusion. 463 U.S. at 176-77. The Court held the taxpayer—a paperboard manufacturer—and its foreign subsidiaries were engaged in a unitary business because there was a substantial "flow of value" between the taxpayer and the subsidiaries. The Court explained:

> The functional meaning of this [unitary business] requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation.

Id. at 166.

Thus, *ASARCO*, *Woolworth*, and *Container*—and *Mobil* and *Exxon*, as well—reaffirmed the vitality of the bedrock unitary business principle and established standards for determining whether the requisite unitary link exists between a nondomiciliary taxpayer's business activities within the State and its extraterritorial investments in or income from other nondomiciliary corporations. The unitary business principle assures that the use of formulary apportionment will be limited to situations where necessary to measure the income attributable to activities in the taxing State. Where a corporation conducts two wholly separate or discrete businesses in different States, formulary apportionment is not necessary—and should

not be permitted—because separate accounting succeeds in measuring the income attributable to the discrete business activities conducted in the taxing States. As this Court said just last year in *Trinova Corp.*, "to allow apportionment where there is no practical or theoretical justification could provide the opportunity for a state to export tax burdens and import tax revenues." 111 S. Ct. at 829.

C. A Decision to Overrule *ASARCO* and *Woolworth* Would Be A Decision to Repudiate the Unitary Business Principle

The foregoing summary of this Court's decisions confirms the broad scope of the first question posed by the Court in setting this case for reargument. The issue is not simply whether *ASARCO* and *Woolworth* should be overruled, for those cases involved simply the application of an established constitutional principle to specific sets of facts.[6] Rather, the Court's question goes to the continued vitality of the unitary business principle itself: Whether the States are free to apportion any and all income of nondomiciliary taxpayers, without regard to whether any, or only an insubstantial, connection exists between the State, the income, and the taxpayer's in-state activities or business.

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[6] In *ASARCO*, the Court observed that the unitary business principle had been a "familiar concept in our tax cases for more than 60 years," 458 U.S. at 320 n.14—back at least to Justice Holmes's 1920 opinion in *Wallace v. Hines* (and, some would argue, back to the 1875 decision in *State R.R. Tax Cases*). Indeed, the Court in *ASARCO* stated that a review of its pre-*Mobil* decisions (including the 1897 decision in *Adams Express*) unmistakably demonstrates that "[f]ormulary apportionment, which takes into account the entire business of a multistate business in determining the income taxable by a particular state, is constitutionally permissible only in the case of a unitary business." *Id.*, *quoting* E. George Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171, 183-84 (1970).

To overrule *ASARCO* and *Woolworth*, the Court would essentially have to conclude that corporate purpose alone should define unitary business. Just as the State argued in *ASARCO*, the Court would have to rule that "intangible income should be considered a part of a unitary business if the intangible property (the shares of stock) is 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.'" *ASARCO*, 458 U.S. at 326 (quoting the State of Idaho's brief). Such an open-ended definition of unitary business, however, would emasculate the concept. As Justice Powell reasoned in *ASARCO*, "[w]hen pressed to its logical limit, this conception of the 'unitary business' limitation becomes no limitation at all"—it "would destroy the concept." *Id.*

The "everything is unitary" analysis propounded by the State of New Jersey should be seen for what it is: an effort to "subvert[] the unitary-business limitation." *Woolworth*, 458 U.S. at 364 n.11. Under its so-called standard, "[a]*ll* dividend income—irrespective of whether it is generated by a 'discrete business enterprise,' *Mobil*, 445 U.S. at 439—would become part of a unitary business if the test were whether the corporation commingled dividends from other corporations, whether subsidiaries or not." *Woolworth*, 458 U.S. at 364 n.11 (emphasis in original).

D. Overruling *ASARCO* and *Woolworth* Would Exacerbate the Potential for Duplicative Taxation

The fundamental purpose of the unitary business principle is to ensure the Due Process Clause rights of multijurisdictional businesses by preventing extraterritorial taxation by the States and placing limits on the potential for duplicative taxation. *Amicus* TEI fears that—absent the imposition of other, arguably more administratively burdensome and intrusive limitations—the evisceration of the unitary business principle would convert the potential for duplicative taxation into reality. And given the

Court's historical reluctance to dictate the specific components of a given State's allocation and apportionment scheme, *Moorman Mfg. Co.*, 437 U.S. at 278-80, the development and imposition of such limitations are not guaranteed.[7]

The unitary business principle operates to limit a State's power to tax the intangible income of nondomiciliary multijurisdictional corporations. Consequently, a decision overruling *ASARCO* and *Woolworth* (and, hence, destroying the unitary business principle) would unleash the States to impose tax on intangible income, without regard to the connection between the income and the taxpayer's activities in the State. Absent clear direction from this Court, such a decision would not *require* all the States to apportion such income, only *free* them to do so, unfettered by the limitations inherent in the unitary business principle. At the same time, the State of commercial domicile would presumably retain the right to allocate the same income.[8]

Clearly, allocation and apportionment of the same income should not occur. "Taxation by apportionment and taxation by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained." *Mobil*, 445 U.S. at 444-45, *citing Standard Oil Co. v. Peck*, 342 U.S. 382, 384 (1952). In other words, because apportionment is a surrogate for allocation, income may not be apportioned if it is fully allocable to a single State. If *ASARCO* and *Woolworth* were overruled, however, the same income could well be subject

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[7] The limitations that *amicus* TEI believes the Court should impose if *ASARCO* and *Woolworth* are overruled are discussed in Part III, *infra*.

[8] Sections 6(c) and 7 of UDITPA allocate capital gains from intangible property, interest, and dividends to the State of commercial domicile.

to both allocation and apportionment, with double taxation being the result.

For example, assume that a company that is domiciled in Pennsylvania operates two grocery stores, one in Pennsylvania (which it operates directly) and one in New Jersey (which it operates through a subsidiary). The property, payroll, and sales factors of the two companies are identical, so that 50 percent of apportionable income is taxed in each State.[9] In addition, the Pennsylvania company owns stock in an unrelated foreign company. In 1990, the Pennsylvania grocery store makes $100 and the New Jersey store also makes $100; in addition, the Pennsylvania company receives $1,000 of capital gain income from the sale of the foreign company stock. As the State of commercial domicile, Pennsylvania allocates the capital gain to itself and apportions the aggregate $200 of grocery store income in accordance with the three-factor formula; *i.e.*, the company's Pennsylvania income is computed to be $1,100. Under New Jersey's analysis, the capital gain would be apportionable, so the company's New Jersey income would be deemed to be $600 (½ [$200 unitary income + $1,000 intangible income]). Hence, although the company realized only $1,200 of total income, an aggregate of $1,700 would be subject to tax.[10]

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[9] For simplicity's sake, assume that the two States have statutory schemes that apportion all business income by way of a three-factor formula with equal weighting to each factor; differences between the apportionment formulae used by the States could exacerbate the degree of duplicative taxation.

[10] As a constitutional matter, it is immaterial whether the State of commercial domicile chooses to allocate all the income to itself. The issue is the nondomiciliary States' *power* to tax, and clearly that power (as constrained by the Due Process Clause) does not expand or contract as the State of commercial domicile exercises or disclaims the full extent of its own power to tax. As the Court observed in *Mobil*, "the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy." 445 U.S. at 444.

E. *Stare Decisis* and the Rule of Law

In disregarding or distending this Court's numerous decisions applying the unitary business principle—including *ASARCO* and *Woolworth*—the New Jersey court ignored a basic principle of constitutional adjudication: It is this Court that prescribes constitutional standards and the lower courts are obliged to adhere to those standards "no matter how misguided the judges of those courts may think [them] to be." *Hutto v. Davis*, 454 U.S. 370, 375 (1982); *accord Cooper v. Aaron*, 358 U.S. 1, 18 (1958); *The Mayor v. Cooper*, 73 U.S. (6 Wall.) 247, 253 (1867) (if the lower courts did not adhere to Supreme Court precedent, there would be "mischievous consequences").

New Jersey, moreover, is not alone in its assault on the Due Process and Commerce Clause protections afforded to multijurisdictional businesses. Taxing authorities in many States have endeavored to chip away at the unitary business principle and the constitutional limitations on state taxation as set forth in *Mobil*, *Exxon*, *ASARCO*, *Woolworth*, *Container*, and earlier cases. For the States, the coin of the realm is seemingly not principle, but revenue.

The unapologetic efforts by the States to tax a portion of intangible income received from non-unitary entities is "a mere effort to reach profits earned elsewhere under the guise of legitimate taxation." *See Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 283 (1924). *Amicus* TEI submits that the States' persistent defiance of precedent cannot be allowed to stand, and it certainly should not be rewarded. If these actions by the States, untethered by principle, are not beyond the pale of the Due Process Clause and the Commerce Clause, then just exactly what protection does the Constitution provide?

Amicus TEI believes the Court should be chary to overturn the unitary business principle and to roil the waters of state taxation of multijurisdictional businesses. As the

Court observed last term "[s]*tare decisis* is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991).

Concededly, the doctrine of *stare decisis* does not mean that all this Court's previous decisions are sacrosanct. But the doctrine is—and should be—"of fundamental importance to the rule of law." *Welch v. Texas Dep't of Highways & Public Transp.*, 483 U.S. 468, 494 (1987).[11] As Justice O'Connor wrote in *Arizona v. Rumsey*, 467 U.S. 203 (1984):

> Although adherence to precedent is not rigidly required in constitutional cases, any departure from the doctrine of *stare decisis* demands special justification. See, *e.g.*, *Swift & Co. v. Wickham*, 382 U.S. 111, 116 (1965); *Smith v. Allright*, 321 U.S. 649, 665 (1944).

Id. at 212. This is especially true where the case pertains to property and contract rights, as well as commercial dealings, which involve reliance interests. *Payne*, 111 S. Ct. at 2610.[12]

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[11] *Accord Hilton v. South Carolina Public Rys. Comm'n*, 112 S. Ct. 560, 563 (1991) (emphasizing "the central importance of *stare decisis* in this Court's jurisprudence").

[12] In *Payne*, Chief Justice Rehnquist noted that one reason the doctrine of *stare decisis* is not as compelling in constitutional cases as elsewhere is that in such cases "correction through legislative action is practically impossible." 111 S. Ct. at 2610, *quoting Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 407 (1932) (Brandeis, J., dissenting). But here, as the Court has acknowledged on many occasions, Congress clearly *does* have the power under the Commerce Clause to intercede and establish firm rules. *See, e.g., Moorman Mfg. Co.*, 437 U.S. at 280 ("It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income.").

Amicus TEI believes the question—*whether ASARCO and Woolworth should be overruled and the unitary business principle be effectively jettisoned from the matrix of constitutional adjudication*—begs its own answer: absolutely not. Indeed, the Court should affirm the vitality of the unitary business principle and hold that the Due Process Clause and Commerce Clause continue to bar efforts to levy upon income that is not properly "within the reach of [the State's] taxing power." *Connecticut General Life Ins.*, 303 U.S. at 80.

II. ANY DECISION OVERRULING *ASARCO* AND *WOOLWORTH* AND UNDERMINING THE UNITARY BUSINESS PRINCIPLE SHOULD BE WHOLLY PROSPECTIVE

For more than 100 years, multijurisdictional businesses have relied on the unitary business principle in conducting their business affairs. The repudiation of that principle and the overruling of *ASARCO* and *Woolworth* would represent a major departure from longstanding principles of Due Process and Commerce Clause jurisprudence. The retroactive application of any decision curtailing the protections afforded by the unitary business principle would work a major hardship on interstate commerce and unjustly reward the States for repudiating this Court's holdings.

The retroactive abrogation of the unitary business principle would also send an ominous signal to all taxpayers concerning their ability to rely on established rules. Not only would multijurisdictional taxpayers be exposed to unexpected and potentially enormous tax liabilities for all open tax years, but they would be deprived of the certainty necessary to conduct their business affairs in an orderly manner, undermining the very purpose of the Commerce Clause. Consequently, if the Court were to overrule *ASARCO* and *Woolworth*, that decision should be applied on a prospective-only basis.

In respect of civil cases, the factors to be analyzed in resolving the retroactivity issue were enunciated by the Court in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). In that case, the Court held that in determining whether a decision should be applied on a prospective-only basis, three factors should be considered:

- *Reliance:* Whether the decision establishes a new principle of law or involves an issue of first impression whose resolution was not clearly foreseen.
- *Purpose:* Whether, based on the history of the rule in question, its purpose and effect, non-retroactive application will advance or retard the operation of the new rule.
- *Inequity:* Whether non-retroactive application is necessary to avoid injustice or hardship.

404 U.S. at 106-07 (paraphrased). Applying the *Chevron* test to the possible overruling of *ASARCO* and *Woolworth* —and the consequent evisceration of the unitary business principle—demonstrates that any such decision should be prospective only.

Clearly, a decision overruling *ASARCO* and *Woolworth* would establish "a new principle of law." Such a decision could not have been foreseen by taxpayers. Indeed, the unbroken chain of Supreme Court cases upholding the vitality of the unitary business principle did nothing but affirm the concept's vigor and pertinence. Thus, multijurisdictional taxpayers unmistakably had constitutionally sufficient cause to rely on *ASARCO*, *Woolworth*, and their predecessors. *Chevron*'s threshold test is satisfied.

Second, the non-retroactive application of a decision overruling *ASARCO* and *Woolworth* would not retard the operation of the post-*ASARCO/Woolworth* rule. After all, the effect of such a decision would not be to vindicate the Due Process and Commerce Clause rights of taxpayers —as was the case in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238, 2253-54

(1990)—but simply to permit (not require) non-domiciliary States to apportion intangible income.

Third, the non-retroactive application of a decision overruling *ASARCO* and *Woolworth* is absolutely necessary to avoid injustice and hardship to the multijurisdictional businesses that relied in good faith on those cases and the unitary business principle. The abandonment of the unitary concept would constitute an abrupt break with the past. Such a move would free the States to scrutinize the tax returns of nondomiciliary taxpayers for all open tax years, thereby upsetting well-founded expectations and exposing the taxpayers not only to the danger of duplicative taxation but also to unavoidable administrative costs. *See Chevron Oil Co.*, 404 U.S. at 106-07 (*citing Cipriano v. City of Houma*, 395 U.S. 701, 706 (1969)). As Justice O'Connor explained in *American Trucking Ass'ns v. Smith*, 110 S. Ct. 2323 (1990), "[w]hen the Court concludes that a law-changing decision should not be applied retroactively, its decision is usually based on its perception that such application would have a harsh and disruptive effect on those who relied on prior law." *Id.* at 2338.[13] Such a harsh and disruptive effect would undeniably be visited upon the multijurisdictional businesses that for more than a century have relied on the unitary business principle. Moreover, the effect of a retroactive decision could be decidedly uneven among taxpayers. Some taxpayers may have only a few years still open under the applicable statute of limitations, whereas others (at least in some States) could have open years extending back to even before *ASARCO* and *Woolworth* were decided.

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[13] *See id.* at 2342 (the purpose of prospectivity is "cushioning the sometimes inequitable and disruptive effects of law-changing decisions"); *United States v. Estate of Donnelly*, 397 U.S. 286, 295 (1970) (Harlan, J., concurring) (the doctrine of *stare decisis* is intended to "avoid jolting the expectations of parties to a transaction").

Where this Court holds a particular practice or taxing scheme to be unconstitutional, the legal system's "built-in presumption of retroactivity," *Solem v. Stumes*, 465 U.S. 638, 642 (1984), should generally obtain. Thus, in *McKesson*, the Court held that the Florida statute there in issue was unconstitutional *ab initio* and that, consequently, the taxpayer was entitled to relief in respect of the discriminatory taxes paid into the State. 110 S. Ct. at 2253-54.

McKesson, however, does not dictate a retroactive decision here. Indeed, since the present case involves a dilution of taxpayers' Due Process and Commerce Clause rights (not their enhancement), there are compelling reasons to apply the decision on a prospective-only basis even if the *Chevron* standards were not clearly satisfied. Hence, the overruling of *ASARCO* and *Woolworth* would be normatively distinguishable from cases where the Court holds state taxing schemes to violate the Due Process and Commerce Clauses. This case involves not a question of constitutional wrongdoing by the unsuccessful party, but rather the potential sanctioning of a scheme of state taxation that previously was found to contravene the Constitution.

Unlike *McKesson* and other cases invalidating discriminatory taxing schemes, the adversely affected taxpayers here violated no legal or constitutional duty and impaired the Due Process and Commerce Clause rights of no one. Because there is no conduct that would be proscribed by the Court's decision, prospective-only treatment is justified. Thus, "[a] basic asymmetry exists between decisions contracting and those expanding the domain of individual rights." *See* Richard H. Fallon, Jr. and Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 Harv. L. Rev. 1731, 1745 (1991).[14] *Amicus* TEI believes that where the Court

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[14] *Cf. id.* at 1745 n.65 ("The retroactive application of a new decision that effectively criminalized conduct that had been previously held immune from prosecution would presumably deny due

moves to contract the protections afforded by the Due Process and Commerce Clauses, it should do so only on a non-retroactive basis.

Whereas retroactive application of decisions holding particular taxes unconstitutional—such as in *McKesson*—provides a clear incentive for States to avoid unconstitutional taxes, Fallon & Meltzer, *supra*, at 1829, the opposite incentive would be provided by the retroactive overruling of *ASARCO* and *Woolworth*: the States would be encouraged to disregard this Court's clear holdings and to construct taxing schemes that run contrary to long-established principles (such as the unitary business principle). Such an occurrence would be tremendously disruptive. Nothing would be settled and the States would be continually emboldened to impose unconstitutional taxes on the chance that, one day, this Court might relent in its reasoned interpretation of the Constitution's Due Process and Commerce Clause protections.[15]

Amicus TEI believes the States should be placed on notice that they cannot disregard this Court's decisions with impunity and that they will not be permited to reap the benefits of their defiance. At a minimum, therefore, any decision restricting the protections afforded by the Commerce and Due Process Clauses should be applied on a wholly prospective basis.

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process."). Among the cases cited by Fallon and Meltzer is *James v. United States*, 366 U.S. 213, 221-22 (1961) (plurality opinion), in which the Court overruled *Commissioner v. Wilcox*, 327 U.S. 404, 408-09 (1946) (which had held that embezzled funds do not constitute taxable income), but reversed the tax evasion conviction of the defendant-embezzler on due process grounds.

[15] The retroactive overruling of this Court's precedents could be interpreted as an invitation to "state actors to renew the very policies deemed unconstitutional in the hope that this Court may now reverse course, even if it has only recently reaffirmed the constitutional liberty in question." *Payne v. Tennessee*, 111 S. Ct. 2597, 2624 (1991) (Marshall, J., with Blackmun, J., dissenting).

III. TOWARD THE DEVELOPMENT OF NEW CONSTITUTIONAL STANDARDS: SAFEGUARDING DUE PROCESS IN THE ABSENCE OF THE UNITARY BUSINESS PRINCIPLE

In *Container*, the Court discussed the standards against which the legitimacy of a State's apportionment formula is to be measured. Observing that "an apportionment formula must, under both the Due Process and Commerce Clauses, be fair," 463 U.S. at 169, the Court explained:

> The first, and again obvious, component of fairness of an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.

Id. Even if *ASARCO* and *Woolworth* were overruled and the unitary business principle jettisoned from constitutional decision-making, this test should continue to govern the propriety of state allocation and apportionment schemes.

As demonstrated in Part I, the unitary business principle operates as a constitutional brake on the States' exercise of raw power by proscribing the States' taxation of value earned outside its borders. If that principle is cast aside, new standards must be developed to ensure that the Due Process and Commerce Clause rights of multijurisdictional businesses are not infringed.

Obviously, a balance must be struck between the States' legitimate need for revenues from activities to which the States accord some benefit and taxpayers' legitimate needs for, and right to, protection from taxing authorities that seek to throw a net over income with which the States have no substantial connection. It is for this Court to

ensure that the balance is a reasonable one. As Justice White observed in *Boston Stock Exch. v. State Tax Comm'n*, the Court has a duty "to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers." 429 U.S. at 329.

The Court has historically accorded a large degree of deference to the States in designing their taxing schemes. *See Moorman Mfg. Co.*, 437 U.S. at 272-73. If the Court should overrule *ASARCO* and *Woolworth*, however, that deference should be clearly circumscribed. In the absence of the unitary business principle, the Court should clarify the principles necessary to minimize duplicative state taxation of intangible income and impose constitutionally based restrictions on the structure of state apportionment formulae. Otherwise, the Due Process and Commerce Clause rights of multijurisdictional taxpayers will suffer.

A. The Need for Uniform Definitions and Apportionment Rules

As explained in Part I.D., *supra*, the evisceration of the unitary business principle would greatly enlarge the potential for duplicative taxation. First, overruling *ASARCO* and *Woolworth* would empower the States to impose tax on intangible income unfettered by the due process considerations that gave rise to the unitary business principle. Although the decision would free the States to apportion such income, it would not necessarily *require* them to do so. Consequently, the same income could be taxable not only by nondomiciliary States (which would be permitted to include it in their apportionable tax base), but also by the State of commercial domicile (which would remain free to allocate the same income in accordance with longstanding principles governing the taxation of business and non-business income). Indeed, several nondomiciliary States might choose to *apportion* the income, whereas one or more other nondomiciliary

States might assert the power to *allocate* the income as attributable to a separate business conducted within their respective borders. Indeed, more than one State might claim that it is the State of commercial domicile and, hence, is entitled to allocate all intangible income. Stated simply, the same income could be subject to tax—not simply apportionment—in several States.

Concededly, the Court has generally eschewed interference with the States' ability to structure their allocation and apportionment schemes. *Moorman Mfg. Co.*, 437 U.S. at 278-79. In a post-unitary business principle environment, however, the Court is obliged to ensure against duplicative taxation. Clearly, there is no constitutional or normative basis for sanctioning the allocation and apportionment (or, indeed, the multiple allocation) of the same income. *Mobil*, 445 U.S. at 444-45, *citing Standard Oil Co. v. Peck*, 342 U.S. at 382, 384 (1952).

Thus, if *ASARCO* and *Woolworth* were overruled, the Court should hold that the States must adopt uniform definitions of the types or items of income that are to be allocated and the types or items of income that are to be apportioned—perhaps even prescribing mandatory apportionment of all intangible income. Clearly, this would represent a significant shift in the relative rights and prerogatives of domiciliary and nondomiciliary States. Clearly, too, it would mark a departure from the view that "only Congress has both the ability to canvass the myriad facts and factors relevant to interstate taxation and the power to shape a nationwide system that [will] guarantee the States fair revenues and offer interstate businesses freedom from strangulation by multiple paperwork and tax burdens." *ASARCO*, 458 U.S. at 331 (O'Connor, J., with Blackmun & Rehnquist, JJ., dissenting).[16]

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[16] *See Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting) ("this Court . . . cannot . . . devise appropriate standards for dividing up na-

In the absence of the unitary business principle, however, judicially prescribed uniformity would be essential to striking the proper balance between the power of the States and the rights of multijurisdictional businesses. It would also be essential to vindicating the principles underlying the Due Process and Commerce Clauses. In other words, the Court's well-founded reluctance to assume this duty should lead it not to sanction an "anything goes" approach by the States, but rather to reaffirm the necessity and essential vitality of *ASARCO*, *Woolworth*, and the unitary business principle while inviting Congress to resolve the issue legislatively.

B. The Compelling Case for Factor Representation

Apart from the need for uniformity is the need for the development of fair apportionment formulae. Here, the issue is not whether the same apportionment formula should be imposed on all the States,[17] but whether the formula used by a particular State is properly designed to guard against the taxation of extraterritorial values.

Amicus TEI submits that, if the Court should rule that a nondomiciliary State is not constrained by the Due Process and Commerce Clauses from apportioning intangible income derived from the business of another corporation, then at a minimum the Court should clarify that the Constitution does not permit such apportionment without taking into account the apportionment factors of the business generating that income. Requiring the States to provide "factor representation" is necessary to prevent the apportionment formula from being unreasonably and impermissibly skewed.

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tional revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subleties of the interrelated economics of Nation and State.").

[17] This question is one, however, that the Court should revisit if the unitary business principle is discarded. *See Moorman Mfg. Co.*, 437 U.S. at 291-97 (Powell, J., with Blackmun, J., dissenting).

In *Mobil*, this Court acknowledged the factor representation issue, but declined to resolve it because the issue had not been raised by the parties. 445 U.S. at 434, 441 n.15, and 449. In his dissenting opinion in that case, however, Justice Stevens addressed the question directly:

> Clearly, it is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income. . . .
>
> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

445 U.S. at 459, 461 (Stevens, J., dissenting.)

In this case, the State of New Jersey included in the apportionable tax base the substantial capital gain the taxpayer had realized upon the sale of stock in an unrelated company, but the State calculated the apportionment ratio solely by reference to the taxpayer's separate payroll, property, and sales. In other words, the payroll, property, and sales factors *that generated the income* were not taken into account in computing the part of the taxpayer's apportionable income that could be taxed by New Jersey. The failure to provide factor representation produced a result that reflected neither "a reasonable sense of how [the] income [was] generated" (as required by *Container*, 463 U.S. at 169), nor "the relative contribution of the activities in the various States [specifically, New Jersey] to the production of total unitary income" (*Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942)). As the Maine Supreme Court recently held in *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991):

> [Without factor representation,] [t]he ineluctable result is that more of the business activity of the unitary business is attributed to [the State] than is the actual case. Thus, the income taxable by [the State] under the Assessor's formula does not truly reflect [the corporation's] connection with [the State] and fails to meet the test of fairness required by the due process clause.

Id. at 1044.[18] Indeed, the Supreme Court of New Jersey has itself recognized that the State has an obligation to adjust the apportionment formula where the taxpayer is unfairly penalized. *F.W. Woolworth Co. v. Director of Division of Taxation*, 213 A.2d 1, 18 (N.J. 1965).

An apportionment formula that fails by design to take into account the out-of-state property, payroll, and sales that generated the apportioned income should be invalidated as "inherently arbitrary," *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), because there can never be a "rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil*, 445 U.S. at 437. Without factor representation, therefore, the apportionment for-

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[18] In addition to Maine, several other States have concluded that the failure to provide factor representation in applying the apportionment rules to *unitary* businesses contravenes the Due Process and Commerce Clauses. *See, e.g., NCR Corp. v. South Carolina Tax Comm'n*, 402 S.E.2d 666, 674 (S.C. 1991) (involving interest and royalties from unitary subsidiaries); *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 422 N.W.2d 629, 636 (Wis. App. 1988) (involving dividends from unitary subsidiaries); *NCR Corp. v. Comptroller of the Treasury*, 544 A.2d 764, 781 (Md. 1988) (involving dividends and royalties from unitary subsidiaries); *Homart Dev. Co. v. Norberg*, 529 A.2d 115, 121 (R.I. 1987) (involving distributive share from partnership). *See* E. George Rudolph, *supra*, 25 Tax L. Rev. at 205 ("Obviously, if the foreign source income is included in the base for apportionment, foreign property, payrolls, and sales must be included in the apportionment fractions. This was recognized in *Bass* [, *Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924] . . .").

mula should be struck down as violating both the internal and the external consistency tests of *Container*. 463 U.S. at 169-70.

In summary, the Court should hold that where a State seeks to apportion intangible income (including capital gains and dividends derived from equity investments), then the State's apportionment formula must be modified to include an appropriate portion of the payor company's payroll, property, and sales. Only by requiring factor representation can the Court vindicate the constitutional requirement of a "fair" apportionment formula. *Container*, 463 U.S. at 169.[19]

IV. SUMMARY

In holding for the State in the proceeding below, the New Jersey Appellate Division stated that "*ASARCO* and *F.W. Woolworth* cast a dark shadow over the Tax Court's decision . . . ." A truer statement is that the decision of the New Jersey Supreme Court, if left to stand, would do more than cast a shadow: it would blot out constitutional protections of more than a century's duration.

Overruling *ASARCO* and *Woolworth* would lead in due course to an unraveling of more than 100 years of consti-

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[19] Moreover, the Court should expressly reaffirm its holding in *Woolworth* that a State's taxation of hypothetical or fictitious income (through its inclusion in the apportionable tax base) contravenes the Due Process Clause. 458 U.S. at 372-73. The term "fictitious income" includes so-called gross-up amounts that a taxpayer never received but that the Federal Government *deems* it to receive from its foreign subsidiaries for purposes of computing the taxpayer's federal foreign tax credit. *See* I.R.C. § 78. In *Woolworth*, the Court dismissed with dispatch the State's argument that *deemed* income was apportionable. That portion of the holding should be reaffirmed even if the unitary business principle is eviscerated by the Court. *Accord George, Inc. v. Norberg*, 444 A.2d 868, 870 (R.I.), *cert. denied*, 459 U.S. 908 (1982); *Commonwealth v. Emhart Corp.*, 278 A.2d 916, 921 (Pa. 1971); *Getty Oil Co. v. Director of Revenue*, CCH Del. State Tax Rptr. ¶ 200-286 (Del. Tax App. Bd. 1975).

tutional jurisprudence. It would rob taxpayers and the States alike of certainty. And it would undermine the principles underlying the Due Process and Commerce Clauses. Consequently, *amicus* TEI urges the Court to reaffirm the vitality of the unitary business principle, refrain from overruling its fact-based decisions in *ASARCO* and *Woolworth*, and send an unmistakable signal to the States that they may not tax extraterritorial income where they have not "given anything for which [they] can ask return."

CONCLUSION

The decision of the Supreme Court of New Jersey should be reversed.

Respectfully submitted,

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April 9, 1992